86-875

No. ____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARTHUR ANDERSEN & CO.,

Petitioner,

—v.—

MANUFACTURERS HANOVER TRUST COMPANY,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

This petition raises three questions. The first two questions implicate this Court's consistent holdings that a general verdict must be overturned if there is a legal defect in any one of the claims underlying that verdict. *See, e.g., Greenbelt Cooperative Publishing Ass'n v. Bresler*, 398 U.S. 6, 11 (1970). The third question concerns the meaning of the "in connection with" requirement of Section 10(b) of the Securities Exchange Act of 1934.

1. Where the jury was instructed to render a single general verdict with respect to three federal securities laws claims, two subsidiary theories of federal securities laws liability, and two common law claims, and where the jury did so, may a post-verdict inquiry of the jurors be used to create a separately-sustainable verdict of "10B5" liability and to avoid an appellate review of legal defects in the other claims submitted to the jury?

2. Even if a post-verdict inquiry could be used to find "10B5" liability, where the jury had been instructed that it could find defendant liable under Section 10(b) of the Securities Exchange Act of 1934 on any one of three legal theories (primary violation, aiding and abetting or conspiracy), did the court of appeals act in conflict with this Court's decisions by assuming that the jury found a primary violation and declining to review the legal defects in the other two theories?

3. Where petitioner's alleged misrepresentations related to the opening capitalization of a government securities dealer but did not pertain to the government notes and bonds that were purchased and sold, were the alleged misrepresentations "in connection with" the purchase or sale of securities as a matter of law?

LIST OF PARTIES

The plaintiff below was Manufacturers Hanover Trust Company. The defendants named in the complaint were Drysdale Government Securities, Inc.; Drysdale Securities Corporation; BMC Acquisition Corp. d/b/a Buttonwood Management; Arthur Andersen & Co.; David J. Heuwetter; Joseph V. Ossorio; and Peter J. Wasserman.

The claims against Arthur Andersen & Co. were tried separately. Arthur Andersen & Co. was the appellant in the court of appeals and Manufacturers Hanover Trust Company was the appellee.

Manufacturers Hanover Trust Company is the respondent before this Court.

Petitioner Arthur Andersen & Co. is a general partnership, not a corporation, and Rule 28.1 does not apply.

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Arthur Andersen & Co. ("Andersen") petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case, entered on September 8, 1986, affirming a $17 million award against Andersen entered on a jury verdict.

OPINIONS BELOW

The opinion of the court of appeals is reported as *Manufacturers Hanover Trust Co. v. Drysdale Securities Corp.*, 801 F.2d 13 (2d Cir. 1986). The opinion is also reported at [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,902, and is reprinted in the Appendix at A1-A35.

The ruling by the United States District Court for the Southern District of New York (Owen, D.J.) on Andersen's motion to dismiss was rendered orally on March 23, 1984. The

relevant portion of the transcript is reprinted in the Appendix at A36-A37.

JURISDICTION

The judgment of the court of appeals was entered on September 8, 1986. On October 20, 1986, the court of appeals denied Andersen's petition for rehearing. A38-A39. On October 29, 1986, the court of appeals stayed the issuance of the mandate until November 26, 1986. A40-A41. This Court has jurisdiction to review the judgment in this case pursuant to 28 U.S.C. § 1254(1).

STATUTES AND REGULATION INVOLVED

This petition involves Section 10(b) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. § 78j(b), and Rule 10b-5 thereunder. 17 C.F.R. § 240.10b-5. It indirectly involves Sections 3(a)(2), 12(2) and 17(a) of the Securities Act of 1933 (the "1933 Act"), 15 U.S.C. §§ 77c(a)(2), 77*l*(2) and 77q(a), respectively. These provisions are reprinted in the Appendix at A45-A49.

STATEMENT OF THE CASE

This case arises out of the collapse of Drysdale Government Securities, Inc. ("DGSI") in May 1982. Manufacturers Hanover Trust Company ("MHT"), plaintiff below, had acted for DGSI as an agent for an undisclosed principal in over $2 billion of transactions involving U.S. government notes and bonds (collectively, "bonds"). MHT was required to fulfill DGSI's obligations in those transactions when DGSI collapsed, and suffered an alleged $21.3 million loss in doing so.

The transactions in which MHT suffered its loss were repurchase and reverse repurchase agreements, or "repos". A repo is a short-term loan of government bonds collateralized by cash.

The loan is in the form of a sale: the lender of the bonds "sells" them for cash, and later "repurchases" the bonds by returning the cash plus interest (called "repo interest") for the use of the cash.

Prior to May 1982 there was an important difference between sales of government bonds in the cash market and "sales" pursuant to repos. When government bonds were sold in the cash market, the sales price included the amount of coupon interest that had accrued on the bonds. In repos, however, the amount of cash paid to collateralize the loan did not include the accrued coupon interest.

DGSI and its predecessor, Drysdale Securities Corporation ("DSC"), took advantage of this disparity. Acting through MHT and other banks, DSC and DGSI borrowed large volumes of government bonds through repos, then sold those bonds in the cash market. By doing so they generated working capital equal to the amount of coupon interest on the bonds they borrowed. Ultimately, on May 17, 1982, DGSI was unable to borrow enough interest-laden government bonds to enable it to meet its obligations to pay coupon interest on the billions of dollars of bonds it had previously borrowed, and it collapsed.

In October 1982 MHT sued DGSI and others, including Andersen, to recover its losses. Its suit against Andersen focused on Andersen's audit report on DGSI's "Statement of Subordinated Debt and Equity as of the Opening of Business on February 1, 1982," reproduced at A56-A59. MHT claimed that Andersen's report and DGSI's Statement fraudulently represented that DGSI had a net worth of $20.8 million on February 1, 1982. MHT further claimed that Andersen had acted negligently in making its examination and report.

MHT's business with DSC and DGSI was conducted solely through MHT's Securities Lending Department. In February 1982, MHT's Wall Street Department reviewed the Andersen report and DGSI Statement as part of a "credit check" to determine whether DGSI was a company in good standing with which MHT should do business. MHT contended that "but

for" Andersen's report the Wall Street Department would not have allowed the Securities Lending Department to continue doing business with DGSI. A55. MHT did not allege that Andersen's report affected the manner in which its Securities Lending Department conducted that business. *Id.*

MHT's claims against Andersen were tried before a jury in February and March 1985. Five primary theories of liability were submitted to the jury: fraud under Section 10(b) of the 1934 Act; fraud and negligence under Section 17(a) of the 1933 Act; fraud under Section 12(2) of the 1933 Act; common law fraud; and common law negligence. As to each of the three claims under the federal securities laws, the jury was instructed that it could also find liability based on either of two "subsidiary theories": aiding and abetting or conspiracy. The trial court denied MHT's request for separate verdicts on each of its claims, and instructed the jury to return a single general verdict. A50, A51.

After deliberating for several hours the jury returned a general verdict in favor of MHT for $17 million. The trial judge then asked the jury "to advise the court on the record of which cause of action or causes of action you base this award on." A52.[1] The jury elected to return to the jury room and, pursuant to an instruction that they were to state by number the statutes violated, the jury returned and the foreman announced that "10B5, Section 12(2), 17A and the two state statutes" were violated. The jury was then discharged without being polled. A53. The court thereafter ordered entry of a judgment reflecting a general verdict. A42.

On appeal, Andersen challenged the legal sufficiency of each of the five theories of liability and two subsidiary theories that were submitted to the jury. Andersen also argued that a legal defect in any one of these theories required reversal, under the rule that a legal error in any one of the claims underlying a

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1 The portion of the trial transcript showing the post-verdict inquiry is reprinted in the Appendix at A51-A53.

general verdict invalidates the verdict. *Greenbelt Cooperative Publishing Ass'n v. Bresler*, 398 U.S. 6, 11 (1970) ("*Greenbelt*"). The court of appeals found "serious questions" as to at least the Section 12(2) claim and the Section 17(a) claim, which the jury was instructed required only a showing of negligence. A11, A25; 801 F.2d at 19, 25. However, the court of appeals held that the jury foreman's reference to "10B5" showed that the jury had found a primary violation of Section 10(b), and concluded that it was not necessary to review the legal challenges to MHT's other claims. A26, A32; 801 F.2d at 25, 28.

As to the Section 10(b) claim, Andersen had renewed on appeal its contention that its alleged misrepresentations did not pertain to the government bonds that MHT purchased and sold in its repos with DGSI, and that MHT's claim that it would not have engaged in those transactions "but for" Andersen's report was insufficient to establish that Andersen's alleged misrepresentations were "in connection with" the purchase or sale of particular government securities. The district court had denied Andersen's motions to dismiss, for summary judgment and for a directed verdict, ruling that repos were themselves "securities" and that Andersen's report, which related to the opening capitalization of the "issuer" of those repos (DGSI), was "in connection with" those securities. *See* A36-A37, A54. On appeal, the Securities and Exchange Commission ("SEC"), in an *amicus curiae* brief invited by the court of appeals, urged that repos are not themselves securities. The court of appeals, however, decided that it was unnecessary to reach this issue. A12; 801 F.2d at 19. It concluded that since a repo is a contract for the purchase or sale of a security, any fraud "in connection with" repos is necessarily fraud "in connection with" the purchase or sale of securities. A13; 801 F.2d at 20.

REASONS FOR GRANTING THE WRIT

Andersen seeks review of the opinion and judgment of the court of appeals in three respects:

First, the court of appeals, by using the jury foreman's answers to a post-verdict inquiry to avoid consideration of serious appeal issues, so far departed from the accepted and usual course of appellate procedure established by this Court, and so far deprived Andersen of its right to a full appellate review of the trial below, as to call for an exercise of this Court's power of supervision.

Second, the court of appeals, by affirming a "10B5" verdict while reviewing only one of the three theories of Section 10(b) liability that were submitted to the jury, has rendered a decision that is in direct conflict with *Greenbelt* and other decisions of this Court.

Third, the court of appeals, in deciding that fraud "in connection with" repos is *necessarily* fraud "in connection with" the purchase and sale of government securities, has decided an important question of federal law and jurisdiction which has not been, but should be, settled by this Court.

I.

The Second Circuit's use of a post-verdict inquiry to avoid consideration of serious appeal issues was a departure from appellate procedures established by this Court, deprived petitioner of a full and fair review of the verdict, and calls for the exercise of this Court's power of supervision.

The trial judge's post-verdict inquiry of the jurors was unprecedented and is not supported by any rule or statute. The effect given to this inquiry by the court of appeals undercuts principles of fairness long established by this Court, and denied Andersen a full and fair appellate review of legal defects in the claims submitted to the jury.

There can be no question that the jury in this case was asked to return, and did return, a single general verdict. A3, A27; 801 F.2d at 15, 26. The court of appeals recognized in principle that a general verdict must be reversed if any one of the underlying legal claims is defective. A31; 801 F.2d at 27-28.[2] It also recognized that there were serious questions about the trial court's instructions as to the Section 12(2) claim and the Section 17(a) claim. A11, A25; 801 F.2d at 19, 25. Andersen had also pointed to serious legal defects in MHT's state law fraud and negligence claims and MHT's charges of aiding and abetting and conspiracy.[3]

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2 This rule has been repeatedly confirmed by this Court. *See, e.g., Greenbelt, supra*; *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co.*, 370 U.S. 19, 29-30 (1962); *United New York & New Jersey Sandy Hook Pilots Ass'n v. Halecki*, 358 U.S. 613, 619 (1959); *Maryland v. Baldwin*, 112 U.S. 490, 493 (1884).

3 Andersen had sought appellate review, *inter alia*, of these matters:

(1) *Section 12(2)*: the submission of a Section 12(2) claim to the jury even though (i) a "repo" is not a "security" and the underlying government bonds were exempt "securities" pursuant to Section 3(a)(2) of the statute, (ii) Andersen's report on DGSI's Statement was not a "prospectus", and (iii) Andersen did not "offer or sell" any securities;

(2) *Section 17(a)*: the existence of a private right of action under this section and the propriety of the charge that "negligence" sufficed to prove a violation of Section 17(a)(2) and (3);

(3) *Aiding and Abetting*: the charge that "recklessness" sufficed to prove scienter under MHT's aiding and abetting claims despite no fiduciary duty owed by Andersen to MHT;

(4) *Conspiracy*: the submission of an unpleaded conspiracy claim to the jury under vague instructions that did not specify the identities of the alleged conspirators, the wrongful act(s) they planned, or the objective of the conspiracy (other than "to defraud Manufacturers Hanover");

(5) *Fraud*: the failure to charge that justifiable reliance is an element of common law fraud under applicable New York law;

(6) *Negligence*: the submission of MHT's common law negligence claim to the jury despite the absence of the "privity" required by New York law. *See Credit Alliance Corp. v. Arthur Andersen & Co.*, 65 N.Y.2d 536, 493 N.Y.S.2d 435, 483 N.E.2d 110 (1985); *Ultramares Corp. v. Touche*, 255 N.Y. 170, 174 N.E. 441 (1931).

However, rather than providing the full appellate review of these issues to which Andersen was entitled, and granting the reversal that such review would have required, the court of appeals focused instead on "rationally maximizing the use of scarce judicial resources" and preserving the results of 6 weeks of trial time. A31; 801 F.2d at 27. Accordingly, it chose to rely upon the post-verdict inquiry of the jury to find a separately sustainable basis for the jury's award.

The post-verdict inquiry came far too late, and was far too casual, to be given this significance. After the jury announced and was polled on its general verdict, thereby completing its assigned task, the trial judge asked:

> "—either you can do it by huddling here or by going back to the jury room—to advise the court on the record of which cause of action or causes of action you base this award on." A52.

The jury chose to retire and some twenty minutes later asked by note whether it was simply to identify the statutes violated or to explain its reasoning. The court replied, "just state by number. State by 10B5, 12(2), 17A." A53. The jury returned shortly and announced:

> "THE FOREMAN: . . . We feel that 10B5, Section 12(2), 17A and the two state statutes.
>
> THE COURT: Were all violated?
>
> THE FOREMAN: Were all violated."

The jury was then discharged, without being polled or asked for any further information. A53.

The court of appeals could cite no precedent for this procedure and recognized that it was not the sort of special verdict process authorized by Fed. R. Civ. P. 49(a). A28; 801 F.2d at 26. It also noted that there was substantial ambiguity in the foreman's response, holding that reliance on the foreman's unclear reference to "state statutes" would constitute "little more than an educated guess." A32; 801 F.2d at 28. All this

having been said, the court nevertheless elevated efficiency over fundamental fairness by treating the jury foreman's "10B5" response as a reliable and reasoned finding of a primary violation of Section 10(b).

There is good reason for the lack of any precedent to support this result. It has long been recognized that a general verdict is an imprecise tool that gives wide latitude to the jury. It permits compromise and serves as a means by which jurors can reach a single result through different paths. " 'The peculiarity of the general verdict is the merger into a single indivisible residuum of all matters, however numerous, whether of law or fact. It is a compound made by the jury which is incapable of being broken up into its constituent parts.' " *Skidmore v. Baltimore & Ohio R.R.*, 167 F.2d 54, 60 (2d Cir.) (citing Sunderland, *Verdicts, General and Special*, 29 Yale L.J. 253 (1920)), *cert. denied*, 335 U.S. 816 (1948).[4]

The rule of appellate review for general verdicts found in *Maryland v. Baldwin*, *supra*, *Greenbelt* and other decisions by this Court acts as a balance to the broad discretion and risk of compromise inherent in the general verdict. This legal review is intended to leave evaluation of the facts to the jury but to ensure that every theory of liability which is proposed to the jury, and which could therefore have supported a juror's acquiescence in the general verdict, is legally sustainable.

The unprecedented procedure sanctioned here completely upsets this balance. Once the jury has rendered its general verdict, the components of that verdict cannot reliably be

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4 *See* Note, *Special Verdicts: Rule 49 of the Federal Rules of Civil Procedure*, 74 Yale L.J. 483, 499 (1965): "Although the theory of the general verdict requires that the jury reach unanimity on all issues in a case, in reality the jury is only compelled to reach *formal* consensus once. '[J]ury verdicts often represent compromises, and it is not so easy to reach separate compromise agreements on several fact findings of a special verdict as it is to agree on one all-inclusive general verdict.' " (*Quoting* Driver, *The Special Verdict—Theory and Practice*, 26 Wash. L. Rev. 21, 24 (1951); footnotes omitted.)

determined by post-verdict inquiry, particularly not by one as casual as the one here. The danger of *post hoc* rationalization is simply too great. Because of this danger, if a jury is to be asked for special or separate verdicts, or to respond to interrogatories, it must be so instructed at the beginning of its deliberations. Fed. R. Civ. P. 49. That is the only way that the jury's careful consideration of these separate issues can reasonably be expected.[5]

In a similar circumstance, the court of appeals recognized this fact, stating that the decisive question is "whether the special interrogatory procedure was planned from the outset or was an afterthought." *Turchio v. D/S A/S Den Norske Africa*, 509 F.2d 101, 104 (2d Cir. 1974). Here the record is clear that the court's inquiry, and almost certainly the jury's response, was simply an afterthought. Reliance on such an afterthought to avoid the serious appeal issues raised by Andersen elevates expedience over fairness and virtually nullifies the *Greenbelt* rule.

Nor would even the limited goals of expedience be served by this nullification of *Greenbelt*. If self-validating responses to a post-verdict inquiry are allowed to undercut appellate review, plaintiffs will be encouraged to follow MHT's lead here and try every conceivable theory to the jury in the hope of gaining a compromise verdict that will be immunized by post-verdict questioning. The end result will not be judicial economy, but additional and unnecessary complexity and delay in pre-trial and trial proceedings.

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5 A similar rule governs practice in English courts. As held by Lord Denning in *Barnes v. Hill*, 1 Q.B. 579, 587, 1 All E.R. 347, 350, 2 W.L.R. 632, 637 (1967), discussing judicial questioning of a jury on the bases of its general verdict, "[o]nce the general verdict was given, that was the end of the case. The judge has no right to ask them any further questions."

While no direct U.S. precedent has been found, the prevailing U.S. rule is that once the jury returns the verdict it is initially asked to return, all that follows is a nullity. *See McDonald v. Pless*, 238 U.S. 264, 267-68 (1915); *McCollum v. Stahl*, 579 F.2d 869, 871 (4th Cir. 1978), *cert. denied*, 440 U.S. 912 (1979); *Phillips Chemical Co. v. Hulbert*, 301 F.2d 747, 750-51 (5th Cir. 1962).

The use to which the post-verdict inquiry was put by the court of appeals is such a serious departure from the appellate procedures established by this Court that it should not be permitted to stand as a guide to the federal trial courts.[6]

II.

The failure of the court of appeals to review all of the theories of Section 10(b) liability that were submitted to the jury is in direct conflict with the decisions of this Court.

The court of appeals sustained the verdict solely on the ground that the jury found a primary violation of Section 10(b). A25, A32; 801 F.2d at 25, 28. The jury had been instructed, however, that it could also find Section 10(b) liability under "subsidiary theories" of aiding and abetting and conspiracy. A50-A51. When the jury foreman responded to the post-verdict inquiry by stating that "10B5" had been violated, he gave no indication of whether he meant that Andersen violated Section 10(b) as a primary violator, an aider or abetter, or a conspirator. Thus, even if some legal significance could be attached to his response, there is still no way of knowing which legal theory or theories formed the basis of the "10B5" finding.

Since either of the "subsidiary theories" could have been the basis for the "10B5" finding, the court of appeals' failure to

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6 While discussing the verdict issue at length, the court of appeals also noted its view that Andersen had not preserved the issue for appeal because Andersen did not object at the time of the inquiry. A27-A28; 801 F.2d at 26. But Andersen does not argue that the error lies in the language the judge used or the form of the inquiry (whether written or oral). Rather, Andersen's argument is that the *procedure* was a nullity, not subject to correction. In such circumstances, objection could have served no purpose and was not required. In this case, moreover, the trial court had advised the parties that it could not conceive of a satisfactory special verdict form and had stated that it would let the parties see any verdict form before use, A50, making any finding of waiver particularly improper and unjust. *See Hetzel v. Jewel Companies, Inc.*, 457 F.2d 527, 535 (7th Cir. 1972).

consider the challenged legal sufficiency of the aiding and abetting and conspiracy claims, A32; 801 F.2d at 28, was directly at odds with the decisions of this Court. This Court has repeatedly held that where a jury's verdict rests on several possible legal theories, the sufficiency of each possible theory must be examined, and the verdict must be overturned if any one theory is defective. *Greenbelt*, 398 U.S. at 11; *Sunkist Growers, Inc. v. Winckler & Smith Citrus Products Co.*, 370 U.S. 19, 29-30 (1962); *United New York & New Jersey Sandy Hook Pilots Ass'n v. Halecki*, 358 U.S. 613, 619 (1959); *Maryland v. Baldwin*, 112 U.S. 490, 493 (1884).

The court of appeals gave no clear explanation for its failure to undertake this required analysis.[7] The court acknowledged *Greenbelt* in passing, A31; 801 F.2d at 27-28, but then cited *Turner v. United States*, 396 U.S. 398, 420-21 (1970), for the proposition that in this case "[t]he judgment herein must be sustained if any one of the indicated bases for the verdict is sustained." A31-A32; 801 F.2d at 28. *Turner*, however, has no applicability to this case, and it in no way justifies the court's refusal to carry out its appellate responsibilities.

In *Turner*, an indictment charged that the defendant purchased, possessed, dispensed, and distributed heroin. 396 U.S. at 402. The statute outlawed the purchase, dispensation, and distribution of heroin, but not its possession. *Id.* at 402 n.2, 420 n.41. The Court, however, held that the evidence of the defendant's "possession" of 275 bags of heroin was sufficient to prove "distribution" and that the guilty verdict should stand. *Id.* at 420.

Turner stands only for the proposition that where an indictment charges several acts in the conjunctive a guilty verdict may be affirmed if the evidence is sufficient to prove any one

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7 Andersen squarely raised this issued in its initial briefs and again in its petition for rehearing at 8-10. The court of appeals summarily denied the petition without clarification of the court's reasoning.

of the acts charged. *Id.*[8] Accordingly, it is akin to such civil cases as *Vareltzis v. Luckenbach Steamship Co.*, 258 F.2d 78 (2d Cir. 1958), which hold that where alternative *factual* theories underlie a single legal claim, and where the evidence is sufficient to support one of the *factual* theories, the jury will be presumed to have found the proper factual path.

Precisely the opposite is the rule where the defect is in a *legal* theory submitted to the jury. Juries are not presumed to distinguish legally valid claims from legally deficient claims. *Turner*, decided before *Greenbelt*, is not authority for ignoring the general verdict rule stated in *Greenbelt*, and the court of appeals was plainly in error in suggesting otherwise.

The rules established by this Court for the review of general verdicts are of immense importance to the proper administration of justice in the federal courts. The court of appeals' refusal to consider Andersen's legal challenges to the aiding and abetting and conspiracy theories of "10B5" liability, A32; 801 F.2d at 28, evidences a disregard for these rules and for the precedents established by this Court. The decision should be reviewed by writ of certiorari and reversed.

III.

The decision below that fraud "in connection with" repos is necessarily fraud "in connection with" the underlying government bonds opens the federal courts to purely state law claims and raises important and unresolved questions that have not been, but should be, settled by this Court.

The district court and the court of appeals each decided the "in connection with" issue as a matter of law, though on

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8 *Turner* was decided in the same term but before *Greenbelt*. The central issue in *Turner*, wholly irrelevant here, concerned the validity of statutory presumptions linking evidence of possession to the prohibited acts of purchase, dispensation and distribution. 396 U.S. at 402-419. *Turner* is not inconsistent with and certainly does not limit the principles of general verdict review set forth in *Maryland v. Baldwin*, *supra*, and reaffirmed, after *Turner*, in *Greenbelt*.

different theories. These decisions are incorrect and are symptomatic of a pervasive confusion in the lower federal courts over the proper interpretation of the "in connection with" requirement of Section 10(b).

This case was tried on the theory that the DGSI repos were themselves "securities" under the federal securities laws; that DGSI was the "issuer" of its repos; and that Andersen's audit report on DGSI's Statement of Subordinated Debt and Equity constituted fraud "in connection with" the sale or purchase of DGSI's repos. Agreeing with this theory, the trial court charged:

> ". . . that the repos and reverse repos involved here are securities within the statutes and therefore, you can take *this element* as established as to each of the federal causes of action." A54 (emphasis added).

This instruction clearly tied the "in connection with" element to the DGSI repos and directed the jury's attention away from the underlying government bonds, as to which Andersen made no representation whatever.

Whether repos are securities is of increasing importance in light of the many recent, notable failures of government securities dealers,[9] and the issue has received inconsistent treatment from the courts and the SEC. *Compare City of Harrisburg v. Bradford Trust Co.*, 621 F. Supp. 463, 469-70 (M.D. Pa. 1985); *SEC v. Gomez*, [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,013 (S.D. Fla. 1985), holding that repos are themselves securities, *with* the SEC's *amicus curiae* brief in the court below, urging that repos are not themselves securities. Brief of the SEC Amicus Curiae, 2d Cir. Dkt. Nos. 85-7827, 7865, 7929 (April 1986).

The court of appeals avoided this issue, declining to rule whether repos are securities. It concluded that a repo is a

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9 *See* S. Rep. No. 99-426, 99th Cong., 2d Sess. 6 (1986). Fraud in repo transactions was involved in a number of these failures. *See, e.g., id.* at 16 n.34.

contract for the purchase and sale of a security and that fraud "in connection with" repos is *necessarily* fraud "in connection with" the purchase or sale of the underlying government securities. A13; 801 F.2d at 20. This approach has also received widespread and inconsistent consideration in the courts. *Compare Abrams v. Oppenheimer Government Securities, Inc.*, 737 F.2d 582, 586-89 (7th Cir. 1984), relied upon by the court of appeals below, *with Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984). If, as decided by the court below and in *Abrams*, every fraud in connection with a *contract* for the purchase or sale of a security is fraud "in connection with" the security purchased or sold, then *Chemical Bank* was wrongly decided. In *Chemical Bank*, a restructuring transaction that was " 'one single, integrated refinancing package' ", 726 F.2d at 933, included a contract for the sale (pledge) of stock, but the court of appeals nevertheless held that the alleged fraud was only "incidental" to the securities pledged and was thus not "in connection with" the sale of those securities.

The court of appeals decision on the "in connection with" issue in this case is also inconsistent with its own decision in a case growing out of the same transactions. *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*, 106 S. Ct. 2894 (1986). There, in overturning a grant of a motion to dismiss, the court of appeals undertook a lengthy analysis of how the evidence at trial might show that the alleged misrepresentations affected the "consideration" in the underlying government bond transactions. 785 F.2d at 42.[10] If, as the court of

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10 Because the issue arose on a motion to dismiss, the court of appeals also accepted as true the SEC's allegations that DGSI and its principals engaged in a fraudulent scheme and that an Andersen partner (Andersen itself was not a defendant) was a party thereto. 785 F.2d at 40, 42. The jury in this case, however, might have concluded otherwise if the "in connection with" issue had been properly submitted to it. The court of appeals in this case, after reviewing the trial record, itself observed that Andersen and the Andersen partner "were not principals in [the DGSI] scheme" and that "[t]here is no evidence that they profited from it, or that they stood to gain anything from DGSI's precarious situation." A6; 801 F.2d at 17.

appeals determined below, fraud in connection with repos is *necessarily* fraud in connection with the underlying government securities, then the court of appeals in the *SEC* case undertook an analysis that was unnecessary. In fact, that analysis is strong evidence of the court's view in that case that the "in connection with" requirement raises an issue of fact to be determined by the jury on proper instructions, which is just the reverse of the procedure that the court followed here.

The confusion created by these inconsistent decisions should be eliminated and the issue should be settled by this Court because:

> "This case is another example of a trend we have observed with disturbing frequency, namely, invocation of the salutary anti-fraud provisions of the federal securities laws in cases where those provisions are wholly inappropriate and wide of the Congressional mark. Moreover, the vice of this practice is compounded here by engrafting upon the misplaced federal securities law claim a state law claim that, but for the federal gloss, should have been litigated in the state courts."

Ryan v. J. Walter Thompson Co., 453 F.2d 444, 445 (2d Cir. 1971), *cert. denied*, 406 U.S. 907 (1972).[11] If, as the court of appeals reasoned, *every* fraud that affects a contract for the purchase and sale of securities is *necessarily* fraud "in connection with" the purchase and sale of those securities, A12-A13; 801 F.2d at 19-20, then the reach of the federal securities laws is virtually limitless.[12]

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11 Quoted with approval in *Kavit v. A.L. Stamm & Co.*, 491 F.2d 1176, 1178 (2d Cir. 1974).

12 On October 28, 1986, the Government Securities Act of 1986 was enacted into law as Public Law 99-571. This legislation does not clarify the status of repos under the antifraud provisions of the federal securities laws and therefore the issue of federal jurisdiction posed herein will continue to be important. Indeed, this legislation may cause the issue to be raised with increasing frequency, as under a new Section 15C(a)(3) to the 1934 Act securities fraud committed by a government

In *Rubin v. United States*, 449 U.S. 424, 429 n.6 (1981), this Court reserved decision on the issue of whether misrepresentations or omissions that do not relate to the value of the securities involved in a transaction and do not otherwise pertain to those securities satisfy the "in" requirement of Section 17(a), the equivalent of the "in connection with" element of Section 10(b). The question reserved by this Court in *Rubin* is squarely posed by this case upon a complete factual record.[13] It was for the trier of fact, the jury, to determine upon proper instructions whether Andersen's alleged misrepresentations were "in connection with" the particular government bond transactions in which MHT incurred its loss. The Court should remand the case for such a determination after first establishing the proper instruction for this important area of federal jurisdiction.

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securities dealer or by "any person acting on behalf of such . . . government securities dealer" will be actionable in the federal courts even where the jurisdictional prerequisites of use of the mails or any means or instrumentality of interstate commerce are absent.

13 A petition for certiorari filed in *SEC v. Drysdale Securities Corp.*, *supra*, raising the issue posed in *Rubin* in another context, *see* note 10, *supra*, was denied. 106 S. Ct. 2894 (1986). Since the ruling in that case was made upon a motion to dismiss, the SEC correctly pointed out in opposition to the petition that "the Court would not at this stage have the benefit of a factual record or findings from the district court." Brief for the SEC in Opposition, No. 85-1744, at 5 n.5 (May 1986).

CONCLUSION

For the foregoing reasons, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Second Circuit.

Respectfully submitted,

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November 26, 1986

APPENDIX

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 794, 858, 795—August Term, 1985

(Argued: March 17, 1986 Decided: September 8, 1986)

Docket Nos. 85-7827, 85-7865, 85-7929

MANUFACTURERS HANOVER TRUST COMPANY,
Plaintiff-Appellee and Cross-Appellant,

—v.—

DRYSDALE SECURITIES CORPORATION; DRYSDALE GOVERNMENT SECURITIES, INC.; BMC ACQUISITION CORP., doing business under the name BUTTONWOOD MANAGEMENT; ARTHUR ANDERSEN & CO.; DAVID J. HEUWETTER; JOSEPH V. OSSORIO; and PETER J. WASSERMAN,
Defendants,

ARTHUR ANDERSEN & CO.,
Defendant-Appellant and Cross-Appellee.

Before:

PIERCE, MINER and ALTIMARI,
Circuit Judges.

Appeal from a judgment entered in the United States District Court for the Southern District of New York, Richard Owen, *Judge*, in favor of plaintiff for $17 million plus interest and costs after a jury trial in an action seeking to recover damages claimed as a result of alleged false representations by an accounting firm made on behalf of a government securities dealer.

Judgment affirmed in part. Award of pre-judgment interest vacated and remanded.

BARRY R. OSTRAGER, Esq., New York, N.Y. (John J. Kerr, Jr., Mark G. Cunha, David W. Sussman, Simpson, Thacher & Bartlett, New York, N.Y., of counsel), *for Plaintiff-Appellee and Cross-Appellant*.

ROBERT L. KING, Esq., New York, N.Y. (Martin Frederic Evans, Michael E. Wiles, Edwin G. Schallert, William F. Haigney, Debevoise & Plimpton, New York, N.Y., Charles W. Boand, Wilson & McIlvaine, Chicago, Ill., of counsel), *for Defendant-Appellant and Cross-Appellee*.

(Daniel L. Goelzer, General Counsel, Jacob H. Stillman, Associate General Counsel, Rosalind C. Cohen, Assistant General Counsel, Richard A. Levine, Attorney, Paul Gonson, Solicitor, Washington, D.C., of counsel), *for Amicus Curiae Securities and Exchange Commission*.

PIERCE, *Circuit Judge*:

The defendant accounting firm appeals from a judgment entered in the United States District Court for the Southern District of New York, Richard Owen, *Judge*, after a jury returned a verdict against it. The jury awarded plaintiff $17 million, to which the district judge added pre-judgment interest, post-judgment interest and costs, in a civil action seeking damages for losses that Manufacturers Hanover Trust Company ("Manufacturers" or "MHT") claimed to have suffered as a result of certain alleged misrepresentations that Arthur Andersen & Co. ("Andersen") made on behalf of Andersen's client, Drysdale Securities Corporation ("DSC") and its successor, Drysdale Government Securities, Inc. ("DGSI"). The district judge submitted seven separate theories of liability to the jury: misrepresentation or material omission "in connection with" the purchase or sale of securities, in violation of section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5, 17 C.F.R. § 240.10b-5, promulgated thereunder; misrepresentation or material omission "in" the purchase or sale of securities, in violation of section 17(a) of the Securities Act of 1933, 15 U.S.C. § 77q(a)(2); misrepresentation or material omission in a "prospectus" or "oral communication," in violation of section 12(2) of the Securities Act of 1933, 15 U.S.C. § 77*l*(2); conspiracy to violate the above federal securities laws; aiding and abetting in the violation of the above federal securities laws; common law negligence; and common law fraud. The jury returned a general verdict, following which the judge requested that the jury state the cause or causes of action on which the verdict was premised, which it did.

On appeal, Andersen argues principally that the district court lacked federal subject matter jurisdiction; that the requisite loss causation standard for liability for securities fraud was not met; that plaintiff MHT caused its loss by its own recklessness; that it was error for the district judge to submit a negligence theory to the jury; that in selecting and instructing the jury the district judge deprived Andersen of a fundamentally fair trial; and that reversal of any of MHT's claims requires reversal of the entire verdict. MHT cross-appeals for a mini-trial exclusively on the issue of punitive damages. We affirm the judgment in favor of plaintiff in the amount of $17 million and deny the relief requested on cross-appeal. We also remand for further proceedings on the issue of pre-judgment interest only.

BACKGROUND

In this civil action MHT sought damages against the Andersen accounting firm, which it asserts made misrepresentations as to the financial status of DGSI, a company created by DSC to transact business through trading in repurchase agreements ("repos") or resale agreements ("reverse repos") involving government securities.[1] DSC, a brokerage house since 1889, engaged in a scheme to purchase and sell government securities through repos and reverse repos beginning in May 1980 and ending in May 1982, just three months after DSC had transfered the repo business to a separate, newly capitalized, corporation called DGSI. The appellees presented evidence to

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1 In a reverse repo transaction, which in economic terms is the identical transaction from the seller's perspective, DGSI would promise to resell government securities on a certain date, and the party dealing with DGSI would rely thereon.

the jury that Warren Essner, a senior Andersen audit partner, misrepresented DGSI's net worth as $20.8 million when it actually was *negative* $190 million.

DSC had transferred the repo business to DGSI in February 1982 for two related reasons. First, it wanted to satisfy banks that had been serving as DSC agents (acting for an undisclosed principal) and that had begun to demand that DSC provide adequate assurances of sufficient capital to absorb the risk of insolvency in the repo market. Evidence was introduced showing that beginning in December 1981, DSC received requests for an audited financial statement from Chase Manhattan Bank, Chemical Bank, U.S. Trust Co., and MHT. Second, DSC wanted to avoid a New York Stock Exchange audit of DSC repo capitalization. The concerns for DSC's financial stability developed as DSC began to lose money because of financial losses in its securities trading and alleged misappropriation of monies by DSC Chairman Joseph Ossorio and DSC trader David Heuwetter.[2]

The mechanics of DGSI's repo business are not disputed. Ossorio and Heuwetter created a so-called "Ponzi" scheme that profited from the use of coupon interest on securities sold. The essence of the scheme was DGSI's exploitation of an important difference between government securities transactions in (1) the "securities" or "cash" market, in which securities are straightforwardly purchased and sold at market prices, and (2) the "repo market," in which government securities are purchased and sold pursuant to repo or reverse repo transactions. In the securities market, the price of a

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2 Ossorio and Heuwetter ultimately pleaded guilty to crimes relating to securities fraud.

government security, such as a United States Treasury note, includes the market price of a particular issue *and* the accrued "coupon interest" on the security (i.e., the value of government payments due on the security at the time of the sale). In the repo market, the accrued coupon interest is paid only on the repurchase (or resale) transaction; the initial "loan" of the security is made at a price that includes only the market value of the security. Before the security is repurchased, its price will be "marked to market" periodically to reflect changed value. By borrowing increasing volumes of government bonds through reverse repos, selling them in the cash market and utilizing the cash and temporarily obtained accrued coupon interest to meet obligations on previously borrowed bonds and to conduct other trades, DGSI managed to stay solvent between February 1, 1982 (when DGSI was created, with the liabilities it had inherited from DSC) and May 17, 1982, when DGSI's ultimate collapse occurred and investors lost some $300 million.

Unlike Ossorio and Heuwetter, Warren Essner, a partner at Andersen, and Andersen itself, were not principals in this scheme. There is no evidence that they profited from it, or that they stood to gain anything from DGSI's precarious situation. Rather, Essner and Andersen had a limited role relating to the *creation* of DGSI. The fundamental issue in this case involves the scope of liability that flowed from this limited role.

Andersen had audited DSC in 1977 and 1978, but had no business relationship with it again until January 8, 1982. On that date, Ossorio contacted Essner at the Andersen firm regarding tax and accounting concerns in the contemplated creation of DGSI. Essner and Ossorio drafted a January 31, 1982 letter announcing DGSI's

formation and discussing its capitalization. The letter was intended for the benefit of potential DGSI clients and indicated that DSC would transfer $5 million in net assets and liabilities to DGSI. (These assets and liabilities constituted repo and reverse repo positions in DSC's portfolio.) In addition, it stated that Heuwetter would invest $12.8 million and Ossorio $2.7 million, bringing the total capitalization to almost $21 million.

There was evidence that during a meeting on January 31, Heuwetter had cautioned Essner about an $11 billion "matched book"[3] of repos and reverse repos that DSC controller Dennis Ruppert (who later pleaded guilty to state securities fraud charges) had fictitiously manufactured to create in part the purported $5 million transfer of DSC positions to DGSI. The true positions concealed by this false "matched book," Heuwetter testified, could not be disclosed, for fear that "if the dealer coummunity found out the size of the positions that I was playing with . . . we would be out of business the next day . . . ."

On the evening of January 31, 1982, Essner prepared a "Statement of Subordinated Debt and Equity" to support the January 31 letter. This document did not disclose the size of the government securities positions transferred from DSC to DGSI. It reflected a purported capitalization of $20.8 million ($5 million net assets and liabilities transferred from DSC plus $15.8 million cash). There was evidence that Essner prepared the statement without consulting DSC's books and records, which, in any event, allegedly had been in incomprehensible disarray.

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3 In a "matched book," a government securities dealer maintains approximately equivalent positions in repos and reverse repos.

On and after February 1, Heuwetter delivered copies of the letter and statement to financial institutions including MHT. However, Chase and MHT pressed for an *audited* financial statement prepared by an independent accounting firm, even though both had been doing business with DGSI since its inception on February 1.

The parties dispute whether Ossorio asked Essner to prepare an audited statement by January 31 or during the week of February 8. In either event, on behalf of Arthur Andersen, Essner prepared a "report on specified elements of a financial statement," which purported to constitute an unqualified opinion prepared in accordance with Generally Accepted Auditing Standards ("GAAS"). There is disputed evidence, however, that Essner never had conducted an audit, and that Essner later manufactured work papers in an apparent effort to legitimize his previous reports. MHT presented evidence at trial that Essner's and Andersen's work violated several procedures required by GAAS[4] as well as many of Andersen's own

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4 For example, MHT adduced evidence that Andersen:

failed to examine DGSI books or records even though Essner knew that $11 billion of securities positions were being transferred from DSC to DGSI;

failed to audit the assets and liabilities transferred from DSC to DGSI even though Essner assigned to them a net value of $5 million;

failed to investigate the adequacy of the internal controls of DSC and DGSI;

failed to verify either that the $15.8 million in deposits in the Chemical account had cleared or that the amounts deposited were free from off-sets;

failed to comply with GAAS related party disclosure procedures;

failed to check for the existence of any material transactions between the date of the audit report and the date that field work was completed; and

dated the audit report prior to the completion of audit field work.

Audit Objectives and Procedures ("AOP").[5] For preparing the letter, statement and report, Andersen billed and received from DSC $14,400. There is no evidence of any other payment to Essner or Andersen.

Andersen introduced evidence that at no time did MHT request a DGSI balance sheet as of February 1, 1982, or a DGSI balance sheet or income statement as of any later date. Andersen also introduced evidence that MHT inadequately monitored DGSI's creditworthiness and MHT's own risk exposure, in contrast to other financial institutions, several of which extricated themselves from business dealings with DGSI in time to avoid the kind of loss that MHT ultimately suffered. MHT countered with evidence that its internal controls over relevant economic risks associated with its business with DGSI was reasonable when viewed in light of prevailing industry practice.

The judge instructed the jury on seven causes of action: the three substantive securities laws, conspiracy and aiding and abetting in the violation thereof, and common law fraud and negligence. He further instructed the jury

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5 For example, MHT adduced evidence that Andersen:

never arranged for a second partner review;

failed to have an audit team work on the audit;

failed to complete a job arrangement letter;

failed to have the audit referenced by an Andersen auditor not connected with the audit;

failed to complete a related party checklist or investigate whether the transaction was done at arm's-length;

added to Essner's audit work papers, long after the purported audit, materials that were unrelated to that audit; and

failed to satisfy Andersen's requirements that a report on a special element of a financial statement be, in the words of Andersen's own accounting expert, "more extensive" than the report that Essner produced.

to find "either in favor of the plaintiff or the defendant." After deliberation, the jury foreman announced that "[w]e find for Manufacturers Hanover." The judge polled the jury, and then asked "which cause of action or causes of action you base this award on." Andersen did not object to this procedure. After returning to the jury room, and after some further instruction from the judge, the jury announced that "10B5 [sic], Section 12(2), 17 A [sic] and the two state statutes" had been violated. The jury was then discharged without another poll or further requests.

DISCUSSION

This case requires us to consider the role of the accountant, and the scope of his liability, in presenting to the financial community information about a financial institution seeking to attract or maintain business in transactions involving agreements to repurchase (or resell) government securities. In an SEC enforcement action arising from many of the same facts herein, we earlier held that the allegation that DSC and three of its officers, and Essner, violated section 10(b) of the 1934 Act and Rule 10b-5 thereunder and section 17(a) of the 1933 Act stated a valid federal cause of action. *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*, 106 S. Ct. 2894 (1986). In this case, we are called upon to review jurisdictional, substantive and procedural issues arising from MHT's private action against Andersen for allegedly misrepresenting DGSI's financial status.

I. *Federal Subject Matter Jurisdiction.*

Andersen argues that repos are not securities, and hence that the district court lacked federal subject matter

jurisdiction over this case. Whether or not repos are securities, it is clear that the district court had jurisdiction as to the claims under section 10(b) of the 1934 Act and section 17(a) of the 1933 Act. In the related litigation of *SEC v. Drysdale*, we assumed that repos and reverse repos are not securities, but held that it would suffice if the alleged fraud by DSC and Andersen were "in connection with the purchase or sale" of securities under section 10(b) and "in the offer or sale" of securities under section 17(a). 785 F.2d at 40-42 & n.2.

Of course, Judge Winter's reasoning in *Drysdale* may not apply to MHT's claim under section 12(2) of the 1933 Act, since the underlying government securities are exempt from the proscriptions of that section. *See* 15 U.S.C. § 77c(a)(2) (exempting securities "issued or guaranteed by the United States"); *id.* § 77*l*(2) (expressly exempting securities defined in subsection 77c(a)(2)). Thus, MHT's claim under section 12(2) may be cognizable only if the repos themselves are securities. However, since we need not decide whether repos are securities to affirm as we do on the sole basis of section 10(b) and Rule 10b-5, *see infra*, we express no view as to whether the submission of section 12(2) to the jury was proper.

II. *Section 10(b).*

A. *Fraud "In Connection With" Repos.*

Andersen argues at the outset that the district court committed reversible error in instructing the jury that repos are securities. We disagree. Although several courts have defined repos, *compare, e.g., SEC v. Miller*, 495 F. Supp. 465, 467 (S.D.N.Y. 1980) (characterizing repos as

essentially short-term collateralized loans); *In re Legel, Braswell Government Securities Corp.*, 648 F.2d 321, 324 n.5 (5th Cir. 1981) (same); *United States v. Erickson*, 601 F.2d 296, 300 n.4 (7th Cir.) ("in substance a secured loan"), *cert. denied*, 444 U.S. 979 (1979); *Ehrlich-Bober & Co. v. University of Houston*, 49 N.Y.2d 574, 577, 404 N.E.2d 726, 728, 427 N.Y.S.2d 604, 606 (1980) ("in essence, a loan transaction"), *with City of Harrisburg v. Bradford Trust Co.*, 621 F. Supp. 463, 469-70 (M.D. Pa. 1985) (repos are securities for purpose of the antifraud provisions of the 1933 and 1934 Acts); *SEC v. Gomez*, [Current Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,013 (S.D. Fla. 1985) (same), the question of whether repos are securities remains unresolved in this Circuit. *See Drysdale*, 785 F.2d at 41 n.2 (assuming without deciding that repos are not securities, but holding that fraud "in connection with" repos is cognizable under section 10(b)). We need not resolve this question to hold, as we do today, that even assuming repos are not securities, the district court's instruction that they are securities, if erroneous, constitutes mere harmless error.

Even assuming that repos are not securities, they are subject to section 10(b) and Rule 10b-5. *See Drysdale*, *supra* at 38; *see also* Securities Act Release No. 33-6351, 1 Fed. Sec. L. Rep. (CCH) ¶ 2024, at 2559-2 (Sept. 25, 1981) ("The antifraud provisions [of the securities laws] . . . apply to the offer, sale and purchase of U.S. government securities occurring in connection with traditional repurchase agreements"); Board of Governors of the Federal Reserve System, Division of Banking Supervision and Regulation, Letter SR-82-25 (FIS), 3 Fed. Banking L. Rep. (CCH) ¶ 60,798.35, at 38,858 (May 13, 1981)

(same).[6] Viewing repos, as we must, from the perspective of their economic significance, *see, e.g., SEC v. W.J. Howey Co.*, 328 U.S. 293 (1946), we think that the repos at issue herein fit squarely within the statutory language in the 1934 Act describing "contract[s] to buy, purchase or otherwise acquire securities." 15 U.S.C. § 78c(a)(13). As such, and consistent with our holding in *Drysdale*, repos are subject to the antifraud provisions of the 1934 Act. *See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 750-51 (1975).

Since repos involve the purchase and sale of securities, it follows that the jury's finding of fraud "in connection with" repos was a finding of fraud "in connection with" the purchase and sale of securities. *See id.*; *see also Abrams v. Oppenheimer Government Securities, Inc.*, 737 F.2d 582, 586-89 (7th Cir. 1984). Indeed, even if one focuses exclusively on the "loan," as opposed to the "purchase and sale," characteristics of repos, for purposes of the antifraud provisions of the 1934 Act, "[t]he terms 'sale' or 'sell' each include any contract to sell or otherwise dispose of a security." 15 U.S.C. § 78(a)(14). The repos herein certainly satisfy that broad definition. *Cf. Yoder v. Orthomolecular Nutrition Institute, Inc.*, 751 F.2d 555, 559 (2d Cir. 1985) (Friendly, J.) (holding cognizable under antifraud provisions of 1933 and 1934 Acts fraud in connection with a "contract for the issuance or transfer of a security").

In our view, the preferred instruction would have been that repos may or may not themselves constitute securi-

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6 We note that in *Drysdale*, the SEC did not contend that repos are securities and that, as *amicus curiae* herein, the SEC has urged that while repos are not securities, they are contracts to buy, sell, or loan securities and are thus subject to the antifraud provisions of the 1934 Act.

ties, but that, in either event, fraud "in connection with" repos satisfies the language in section 10(b) and Rule 10b-5 relating to "fraud in connection with the purchase or sale of securities." Nonetheless, the district judge's additional comment that repos themselves are securities, if inaccurate, amounts to mere harmless error in this case.

B. *Causation and Andersen's Recklessness Defense.*

As for the alleged violation of section 10(b), for which accountants may be held primarily liable, *see, e.g., Herman & MacLean v. Huddleston*, 459 U.S. 375 (1983); *Competitive Associates, Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 815 (2d Cir. 1975); *Fund of Funds, Ltd. v. Arthur Andersen & Co.*, 545 F. Supp. 3314, 1351-53 (S.D.N.Y. 1982), Andersen argues principally that MHT failed to demonstrate "loss causation," and that the jury was not properly instructed on this element of the section 10(b) theory. The standard for liability in a civil action under section 10(b) is causation not merely in inducing the plaintiff to enter into a transaction or series of transactions, but causation of the actual loss suffered. *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930, 943 & n.23 (2d Cir.) (Friendly, J.), *cert. denied*, 105 S. Ct. 253 (1984); *Marbury Management, Inc. v. Kohn*, 629 F.2d 705 (2d Cir.), *cert. denied*, 449 U.S. 1011 (1980); *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974), *cert. denied*, 421 U.S. 976 (1975). It is clear that on the record evidence a fact-finder could conclude that Andersen's misrepresentations as to DGSI's solvency induced MHT (and other financial institutions) to do business with the newly-formed DGSI. There was evidence that the financial

community, including MHT, sought assurance of adequate capitalization of DSC amidst growing concerns of insufficient funding; that Andersen materially misstated DGSI's capitalization in its audited financial statement; and that copies of the Andersen statement were distributed in Andersen envelopes with Andersen's knowledge to various financial institutions including MHT. There was evidence that MHT Senior Vice President Stephen Goodhue, head of MHT's Wall Street Department, relied primarily, though not exclusively, on the Andersen statement in approving DGSI for its government securities business. In light of this evidence, Andersen challenges the adequacy of the charge and the sufficiency of the evidence not as to "transaction causation" but only as to "loss causation."

The requirement of "loss causation" derives from the common law tort concept of "proximate causation." *See Marbury Management*, 629 F.2d at 708 (citing Restatement (Second) of Torts § 548A (1977)). In addition to this requirement as to the significance of the misrepresentation in the chain of causation, "loss causation" "in effect requires that the damage complained of be one of the foreseeable consequences of the misrepresentation." *Id.* (citing *Olek v. Fischer*, [1979 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,898, at 95,702-03 (S.D.N.Y. 1979), *aff'd*, 623 F.2d 791 (2d Cir. 1980)).

We find Andersen's argument that the district court failed to instruct the jury properly on "loss causation" to be without merit. The district judge clearly defined "proximate causation" and used that term throughout his charge. In defining the term, the judge specifically noted the requirement "that the damage was either a direct

result of the misleading statement or one which could reasonably have been foreseen." Further, the judge charged that the jury must determine whether any of MHT's loss was due to its own business shortcomings; whether the bank caused its own losses, and if so, to return a verdict for Andersen even if Andersen acted improperly; whether Andersen caused part and MHT caused part of MHT's loss and, if so, to determine how much loss is attributable to Andersen; whether MHT had satisfied its burden of demonstrating that its loss was not caused by its own recklessness or negligence, and if MHT's recklessness caused any or all of its damage, then Andersen is not liable for such damage; and whether any of MHT's loss was caused not by Andersen's conduct but by MHT's own recklessness or the conduct of third parties, and if so, then MHT is not entitled to recover for such loss. Indeed, we note that the court's proximate cause charge was virtually identical to the charge requested by Andersen.

When it comes to evaluating the evidence of "loss causation," we cannot accept Andersen's argument, premised in part on *Bennett v. United States Trust Co.*, 770 F.2d 308 (2d Cir. 1985), *cert. denied*, 106 S. Ct. 800 (1986) that "there is simply no direct or proximate relationship between the loss and the misrepresentation." *Id.* at 314. In *Bennett*, plaintiffs borrowed funds from the U.S. Trust Co. to purchase utility stocks which were then deposited with U.S. Trust as collateral. The stock declined in value, and ultimately U.S. Trust liquidated plaintiffs' account. Plaintiffs not only lost their equity in the stock, but also became liable to U.S. Trust for $1.2 million in unpaid interest and principal on their loan. Plaintiffs sued U.S.

Trust, claiming that in making the loan, U.S. Trust knowingly or recklessly misrepresented to them that the Federal Reserve margin requirements do not apply to public utility stock deposited with a bank as collateral. Plaintiffs did not and could not allege, however, that U.S. Trust in any way recommended that they purchase public utility stock in general, or any particular public utility stock. Rather, "[t]he Bennetts, and the Bennetts alone, decided to invest in public utility stock." *Id.* at 313-14. The same cannot necessarily be said of MHT. There was certainly evidence upon which a rational trier of fact could find, as the jury apparently found, that Andersen, by its misrepresentations, induced MHT to enter into repurchase agreements with DGSI involving the particular underlying government securities. The financial community had come to mistrust DSC's solvency before the Andersen report was issued. In this context, the Andersen report portrayed a new, highly capitalized company on whose promises to repurchase or resell particular government securities, an institution such as MHT could reasonably rely. Andersen was aware that its report was intended to be and actually was circulated to institutions including MHT for the purpose of inducing them to participate in government securities repurchase agreements.

This case is thus distinguishable from *Bennett* and more similar to *Marbury Management*, *supra*. In the latter case, a trainee in a brokerage firm misrepresented his expertise by claiming that he was a stockbroker and a "portfolio management specialist." That misrepresentation induced the plaintiffs to purchase and retain specific securities that the trainee recommended, despite their misgivings about the stock. Similarly, by misrepresenting

DGSI's financial status, Andersen may reasonably have been found to have induced MHT to enter into repurchase agreements involving DGSI government securities, despite MHT's (and the financial community's) earlier misgivings about the financial risk associated with entering into precisely these agreements with DGSI. Further, although the misrepresentation in *Marbury Management* did not go to the intrinsic *investment characteristics* of the stock, it did go to the *investment quality* of the stock purchases because, had the plaintiffs known that their "broker" was an inexperienced trainee, they asserted they would not have accepted his recommendations, especially given their initial reservations. Similarly, although the misrepresentation in the present case did not go to the *investment characteristics* of the underlying government securities—and, under our holding in *Drysdale*, this was not required—it did go to the *investment quality* of the repos since, presumably, MHT would not have contracted with DGSI to purchase and sell government securities had MHT known of the misrepresentation regarding DGSI's finances, particularly given that the Andersen statements were in part a response to the financial community's concern regarding DSC's stability.

Andersen also relies heavily on *Edwards & Hanly v. Wells Fargo Securities Clearance Corp.*, 602 F.2d 478 (2d Cir. 1979), *cert. denied*, 444 U.S. 1045 (1980), and argues that MHT's alleged "recklessness" caused its own loss, and that the verdict in the district court therefore contravenes the established principle that " '[t]he securities laws were not enacted to protect sophisticated businessmen from their own errors of judgment.' " *Id.* at 486

(quoting *Hirsch v. du Pont*, 553 F.2d 750, 763 (2d Cir. 1977)). In our view, Andersen misapplies this principle in seeking to resurrect imperfections in MHT's internal operations as a bar to recovering for losses caused by Andersen's misrepresentations. *Cf. Faller Group, Inc. v. Jaffe*, 564 F. Supp. 1177, 1181 (S.D.N.Y. 1983) (failure to initiate certain investigative checks does not bar action for fraud) (citing *Mallis v. Bankers Trust Co.*, 615 F.2d 68 (2d Cir. 1980) (Friendly, J.), *cert. denied*, 449 U.S. 1123 (1981); *Dupuy v. Dupuy*, 551 F.2d 1005 (5th Cir.) (Wisdom, J.), *cert. denied*, 434 U.S. 911 (1977)).

We note the applicable legal standard regarding plaintiff's conduct. Plaintiff's burden of persuasion "is simply to negate recklessness when defendant puts that in issue, not to establish due care." *Mallis*, 615 F.2d at 79 (footnote omitted). Thus, although *Edwards & Hanly* had expressly "approach[ed] the issue of [plaintiff's] conduct from the standpoint of . . . due diligence," 602 F.2d at 485, the applicable standard is recklessness. We note, however, that Judge Friendly asserted in dicta that "[t]he facts in *Edwards & Hanly* would have led to dismissal under the *Dupuy* [recklessness] standard." *Mallis*, 615 F.2d at 79 n.9.[7]

In our view, the evidence adduced at trial demonstrates that Andersen's reliance on *Edwards & Hanly* is mis-

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7 *Dupuy* replaced the traditional due diligence-negligence test of plaintiff conduct in a civil action under section 10(b) with the less stringent recklessness standard, thereby harmonizing the plaintiff conduct doctrine with the Supreme Court's imposition of proof of *scienter* in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976). *See Dupuy*, 551 F.2d at 1013-24. Thus, notwithstanding language in *Edwards & Hanly* regarding "due care," the *Dupuy* recklessness standard, as adopted by this Circuit in *Mallis*, 615 F.2d at 78-79 & n.9, remains the standard under which we are to evaluate Andersen's arguments regarding MHT's conduct.

placed, and its arguments of recklessness on MHT's part unpersuasive. We note that plaintiff Edwards & Hanly, a brokerage house, was denied recovery because, in that case,"[t]he primary cause of E & H's loss was its failure to comply with Regulation T, . . . [promulgated] pursuant to § 7 of the Exchange Act, 15 U.S.C. § 78g." 602 F.2d at 486. Regulation T expressly requires broker-dealers, such as E & H, to ensure that a security purchased in a cash account is "held in the account" or that "the creditor accepts in good faith the customer's statement that the security is owned by the customer or the customer's principal, and that it will be promptly deposited in the account." *See* 12 C.F.R. § 220.8(a)(2). In the present case, however, Andersen has not alleged any particular regulatory violation by MHT, which, in any event, was acting not as a broker purchasing or selling securities for its customer, but as fiscal agent for an undisclosed principal, providing for its customers short-term repo and reverse repo positions in government securities, and assuming responsibility to its customers for DGSI's obligations. Of course, MHT may be denied recovery on the basis of adequate proof of common law recklessness as assessed in light of industry practice. We do not wish to suggest that a defendant must show a violation of some statutory or regulatory proscription to show recklessness. But the lack herein of an established statutory or regulatory cognate to Regulation T, violation of which was central to our holding in *Edwards & Hanly*, forces us to inquire as to what, if anything, in this case stands as similarly compelling proof of recklessness.

Andersen's arguments on this critical issue rest principally on its comparisons of various aspects of MHT's DGSI transactions with those of other financial institu-

tions that managed to escape the DGSI collapse either unscathed or considerably less harmed than was MHT. We find these arguments ultimately unpersuasive. For example, Andersen argues that MHT recklessly failed adequately to control its own volume and other risks. Volume risks relate to the amount of money that MHT invested in repo and reverse repo positions with DGSI at any one time. Although some financial institutions, such as Merrill Lynch, Dean Witter Reynolds, Salomon Brothers, First Boston, Citibank and Prudential-Bache, determined that they would transact from zero to $50 million worth of repo business with DGSI, based principally on its cash reserves, there was also evidence that other reputable firms, notably U.S. Trust Company and Chase Manhattan Bank, transacted some $2 to $2.5 billion in repo business with DGSI, as did MHT. Thus, industry practice as to volume risk was not nearly as uniform as Andersen would suggest. Further, volume risk is but one element in total risk exposure, and its significance in the calculus of total risk exposure may be diluted to the extent that the primary government securities dealer, here, DGSI, maintains matched books of repos and reverse repos, a practice that DGSI fraudulently purported to maintain. There was evidence regarding the government securities business of other primary dealers, W.E. Pollack, Prudential-Bache, and Dean Witter, suggesting that the volume of business transacted by DGSI generally and with a particular customer, such as MHT, might have comported with the practices of those firms had matched books in fact been sustained.

As to non-volume risk controls, Andersen introduced evidence that MHT failed adequately to monitor the following: the "market risk" that the cash and bonds

which it received from DGSI might be worth less than the cash and bonds delivered to DGSI; the "coupon interest risk" that DGSI might fail to pay accrued coupon interest when due or to return borrowed bonds; and the "repo interest risk" that DGSI might fail to pay repo interest owed. But there was also evidence—certainly enough to allow a jury to find the claim of recklessness negated—that MHT monitored these risks reasonably when measured by prevailing industry practice. As to "market risk," there was evidence that MHT followed the common industry practice of "marking to market" at 100% of the stated par value of the securities. U.S. Trust, the only other intermediary bank that testified as to risk control, apparently marked to market in the same way as MHT: the intermediary bank would not initiate marks, but would process the marks requested by the principals to the transactions. There was also evidence that MHT periodically checked to ensure that the DGSI transactions were being marked to market. In our view, the evidence of these internal controls by MHT was sufficient to justify a jury's negating the charge of recklessness as to market risk, whether or not MHT could have or should have actually initiated, as opposed to merely processed and periodically monitored, markings to market. *Cf. Faller Group, Inc.*, 564 F. Supp. at 1181 (failure to initiate further investigative checks did not bar action for fraud) (citing *Mallis*, *supra*; *Dupuy*, *supra*).

As to "coupon interest risk," there was evidence that MHT's handwritten records were transcribed from computerized risk assessments that were substantially similar to Andersen's own computer assessments of accrued coupon risk, except that MHT's program entailed a one-day lag in calculation and did not account for DGSI

"fails" in tendering cash or securities due by the time the Fed wire closes at the end of a business day under reverse repos until MHT employee D'Amore corrected by hand the computer assessment each day to account for such fails. There was also evidence that MHT controlled coupon risk by demanding that DGSI process more repos than reverse repos through MHT, thereby reducing risk since, with repos, the borrower was obligated to remit coupon interest to DGSI, while with reverse repos, DGSI was obligated to remit coupon interest to the lender. Further, there was evidence that in monitoring coupon risk, MHT set up a collateral account into which DGSI was to deposit cash and securities to cover MHT's coupon interest exposure. Andersen's own expert on repo procedures, Robert Bird, conceded that prior to DGSI's collapse, it was not the industry practice to collateralize accrued coupon interest, and that MHT's coupon risk controls, including its collateral account, constituted "a fair effort to attempt to control the coupon exposure." Certainly these internal controls render MHT considerably more conscientious than E & H, which often failed even to mark the defendant's sales "long"—a failure "which alone might not even be a breach of duty." *Edwards & Hanly*, 602 F.2d at 486 (citing *Naftalin & Co. v. Merrill Lynch, Pierce, Fenner & Smith*, 469 F.2d 1166, 1175 (8th Cir. 1972)). Also, even assuming, *arguendo*, that Andersen is correct that MHT often failed to enforce this collateral control procedure when DGSI ignored requests for additional collateral, the mere institution and partial enforcement of the collateral control procedure appears to have rendered MHT ahead of, not behind, then-prevailing industry practice in monitoring coupon interest risk.

As to "repo interest risk," there was evidence only that at least two other firms had developed computer programs to monitor this risk, the importance of which must not be overstated in the total calculus of risk, and that MHT was beginning to develop its own program when the collapse occurred.

In short, applying the overall standards of industry practice, the jury reasonably could conclude that MHT endeavored to control risk sufficiently to negate Andersen's claim of MHT's recklessness.

Andersen also argues that MHT recklessly failed to heed warning signs of DGSI's impending collapse. In our view, Andersen relies improperly on *Edwards & Hanly* and thereby mischaracterizes MHT's immediate response to warning signals as a longer-term organizational policy of conscious avoidance. During the approximately one month preceding DGSI's collapse, DGSI often failed to return securities due. As Andersen points out, in April 1982 "fails" lasting three or more days occurred on 58 percent of DGSI's scheduled returns. But the countervailing evidence was sufficient to allow a finding that the charge of recklessness had been negated: MHT officers Martello, D'Amore and Zinns apparently worked with DGSI in April and May in an effort to reduce exposure risks; and, in May 1982, MHT was in daily communication with DGSI regarding the former's exposure. Further, there was evidence that in MHT's experience, DGSI consistently cured fails, and that, in any event, only fails that occurred in the week prior to the collapse of DGSI were still open on May 17, 1982. This contrasts with *Edwards & Hanly*, where, in response to fails of up to several months for securities due within several days, repeatedly over a period of approximately one year,

plaintiff E & H made only "sporadic inquiries" and even then apparently contented itself with evasive answers. *Edwards & Hanly*, 602 F.2d at 486-87. Finally, we must recognize the sheer speed of events herein in contrast to *Edwards & Hanly*. While E & H had approximately one year during which it could have protected itself from ongoing fails, here MHT had at most one-quarter to one-third that duration from the time of the circulation of the Andersen statement in February 1982 until the ultimate collapse of DGSI in May 1982. Indeed, the duration must be considered shorter still when measured from the time when fails became a legitimate source of concern. In sum, as to the brief period of MHT's interaction with DGSI, the evidence supports the conclusion that MHT endeavored to protect its investments, and negated the charge of recklessness.

III. *Section 17(a) of the 1933 Act.*

Since we affirm the judgment of the district court on the basis of section 10(b) of the 1934 Act, we need not reach the issues raised herein as to whether there is an implied private right of action under section 17(a) of the 1933 Act, and, if so, whether liability thereunder may be predicated on the basis of mere negligence. *See Zerman v. Ball*, 735 F.2d 15, 23 (2d Cir. 1984) (declining to decide whether a private right of action exists under section 17(a) of the 1933 Act since plaintiff might instead prevail on the basis of Rule 10b-5). However, nothing in our opinion today should be construed as commenting in any way on Judge Friendly's recent admonition that our conclusion in *Kirshner v. United States*, 603 F.2d 234, 241 (2d Cir. 1978), *cert. denied*, 442 U.S. 909 (1979), that such a private right of action exists, "may be open to reexamination." *See Yoder*, 751 F.2d at 559 n.3.

IV. *The Verdict.*

Much is made by both sides on this appeal of the import of the procedures surrounding the return of the jury verdict. In our view, the procedures employed by the district judge do not warrant reversal, as Andersen now urges, or a review of five allegedly valid verdicts, as MHT now urges. Rather, we think it appropriate to review, as we have done, only the substantive federal securities cause of action, namely, the claim, made under section 10(b), as to which we can say with certainty that a clear and explicit verdict has been rendered. *Cf. Morris v. Pennsylvania R. Co.*, 187 F.2d 837, 841 (2d Cir. 1951) (errors in verdict procedure should be "localized so that the sound portions of the verdict may be saved") (Clark, J.).

On the morning of the jury charge, the district judge informed counsel that he "did not find satisfactory any form of [special] verdict sheet." The judge charged the jury on the three federal substantive securities claims, the federal "subsidiary theories" of conspiracy and aiding and abetting and the two state common law theories of fraud and negligence. He instructed the jury to find "either in favor of the plaintiff or the defendant, and if your verdict is in favor of the plaintiff you are to state the amount of damage that you find." Later, he sent into the jury room copies of the conspiracy and aiding and abetting charge. At 5:48 p.m., the jury announced its verdict, as follows:

THE FOREMAN: We find for Manufacturers Hanover.

THE CLERK: In what amount?

THE FOREMAN: 17 million.

Judge Owen then asked the jury "to advise the court on the record of which cause of action or causes of action you base this award on." Counsel for neither side objected. The jury returned to the jury room. A few minutes later, the jury asked by note whether it was to identify by number the statutes that had been violated or to explain its reasoning. The court responded, "Just state by number." Although it is only of contextual interest, at this time the jury apparently had in the jury room that portion of the charge reciting the language of Rule 10b-5 and §§ 10(b), 12(2) and 17(a) and the charge on aiding and abetting and conspiracy, but not on fraud and negligence. At approximately 6:17 p.m., the jury returned, and the following colloquy ensued:

THE COURT: Mr. Foreman, you are prepared to state which of the statutes were violated?

THE FOREMAN: Yes, your Honor. We feel that 10B5 [sic], Section 12(2), 17 A [sic] and the two state statutes.

THE COURT: Were all violated?

THE FOREMAN: Were all violated.

Without further questions, polling, or objection, the judge then excused the jury.

Andersen contends that the judge's request for the bases of the jury's verdict was improper and thus failed to convert to a special verdict the jury's initial general verdict, as to which a reversal on any one claim would necessitate a new trial. We note that Andersen failed to object to the request, and thus has not preserved this issue for appeal. *See, e.g., Turchio v. D/S A/S Den Norske*

Africa, 509 F.2d 101, 105 (2d Cir. 1974). Andersen's response to this point—that the request was a nullity, and hence required no objection—begs the very question that Andersen itself raises as to whether the request was legally a nullity. Whether a request regarding a verdict is timely is a proper legal question. *Cf. Baker v. Sherwood Construction Co.*, 409 F.2d 194, 195 (10th Cir. 1969) (per curiam) (too late to poll the jurors individually after clerk read verdict and jury was polled collectively and excused). In general, counsel must object to any procedure that it wishes to raise on appeal. *See* Fed. R. Civ. P. 46; *Robinson v. Shapiro*, 646 F.2d 734, 742 (2d Cir. 1981). Further, the failure to object precludes Andersen from contesting the oral, as opposed to written, form of the inquiry. *Turchio*, 509 F.2d at 105.

As to the propriety of the judge's request, our standard of review is the abuse of discretion standard. *See Cann v. Ford Motor Co.*, 658 F.2d 54, 58 (2d Cir. 1981), *cert. denied*, 456 U.S. 960 (1982). We note first that the request was not "tantamount, in its effect, to a direction to the jury" to alter or otherwise compromise the decisiveness of its ultimate verdict. *Compare McCollum v. Stahl*, 579 F.2d 869, 871 (4th Cir. 1978) (resubmission of interrogatories as to damages and defendant's conduct after jury found no wrongful conduct by defendant held improper), *cert. denied*, 440 U.S. 912 (1979). Further, the request for the legal basis for the verdict did not result in the rendering of a special verdict under Fed. R. Civ. P. 49(a). The term "special verdict" is a term of art, and properly speaking, refers only to special findings regarding *factual* issues that the court may ask the jury to resolve, *see Griffin v. Matherne*, 471 F.2d 911, 917 n.6 (5th Cir. 1973); *Skidmore v. Baltimore & Ohio R. Co.*, 167 F.2d

54, 65-70 (2d Cir.), *cert. denied*, 335 U.S. 816 (1948); 9 C. Wright & A. Miller, Federal Practice and Procedure § 2506, at 498-502 (1971), or perhaps mixed questions of law and fact, assuming applicable legal standards are charged. *See* Wright & Miller, *supra* at 502. By contrast, Judge Owen simply asked the jury to specify the cause or causes of action upon which it based its verdict; in short, he inquired as to the legal basis or bases of its verdict. Again, we note counsel's failure to object to the oral form of the inquiry or the answers.

In any event, we find no basis for concluding that this sequence resulted in *post hoc* rationalization by the jury. *See Litton Systems, Inc. v. American Tel. & Tel. Co.*, 700 F.2d 785, 802-04 (2d Cir. 1983) (upholding post-verdict resubmission of unresolved mixed questions), *cert. denied*, 464 U.S. 1073 (1984). In our view, the potential for inaccuracy or mere rationalization might be significant with factual interrogatories, since in reaching its verdict, the jury may not collectively have resolved the particular factual questions posed. By contrast, with a post-verdict inquiry into the *legal basis* for a verdict, as in the present case, it is virtually inconceivable that the jury, having deliberated and returned a verdict, had not already considered the question posed and thus would provide a mere rationalization in its response to the post-verdict inquiry.

In his initial charge, Judge Owen effectively had instructed the jury to consider the very issue presented in the post-verdict inquiry—the seven possible bases for any finding of liability—and had instructed the jury on the elements of each of the seven causes of action. Juries are presumed to follow instructions. *United States v. Siegel*, 717 F.2d 9, 19 (2d Cir. 1983) (citing *Watkins v. Sowders*, 449 U.S. 341, 347 (1981)). Andersen offers no reason to

believe that the jury did not consider the seven causes of action charged in reaching its verdict. Further, Andersen certainly has shown no reason to suspect that, once Judge Owen submitted the post-verdict request to the jury, the jury did not earnestly consider, resolve, and report the results of its deliberations. *See Litton Systems*, 700 F.2d at 803-04 (no basis to conclude that jury did not deliberate conscientiously over post-verdict resubmission of unresolved law/fact interrogatories). Thus, the post-verdict question does not undermine the fairness or decisiveness of the verdict.[8]

The legal inquiry herein is also justifiable on grounds similar to those advanced in support of a separate post-verdict interrogatory on damages, *see* 5A J. Moore, Moore's Federal Practice ¶ 49.06, at 2236 (1971), or a jury's *sua sponte* itemization of damages returned with its general verdict, *see Dagnello v. Long Island Railroad Co.*, 193 F. Supp. 552, 554 (S.D.N.Y. 1960) (Weinfeld, J.), *aff'd*, 289 F.2d 797 (2d Cir. 1961). In *Dagnello*, Judge Weinfeld justified the *sua sponte* itemization thusly:

> Since the jury's method of computing the damages is before the Court, it is desirable that it remain as of record so that if the defendant is advised to prosecute an appeal, the reviewing court will have knowledge of the basis upon which the jury reached its judgment.

Id. It was because the jury's additional finding went to the legal "basis" of the verdict that the finding was legitimate in *Dagnello* as in the instant case.

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8 Further, responses to factual interrogatories, because they will later be subject to the clearly erroneous rule on appeal, portend a graver risk of manifest injustice if hastily made than does a jury's statement of the legal basis for its verdict, which may be reviewed by an appellate court under the mere error standard.

Finally, in the present case, which entailed six weeks of trial time to resolve complex securities issues pleaded on seven distinct theories, the jury's post-verdict specifications play an important role in rationally maximizing the use of scarce judicial resources. *See Berkey Photo Inc. v. Eastman Kodak Co.*, 603 F.2d 263, 279 (2d Cir. 1979) (urging use of special verdicts and interrogatories in "large and complex cases" to resolve issues, reduce probability of "laborious and expensive retrial," and facilitate appellate review), *cert. denied*, 444 U.S. 1093 (1980). We wish to emphasize that the preferred procedure, in the interest of avoiding confusion or unnecessary use of trial time, would have been for the district judge to request a statement of the bases for the verdict in his initial instructions and to provide the jury with a written interrogatory form. However, it is clear that in some instances additional instructions may be given even after a jury begins deliberations or returns a verdict. *See, e.g., Litton Systems*, 700 F.2d at 802-04. The particular inquiry herein did not portend manifest injustice but rather promoted a more complete record; hence, we do not hold the procedure invoked invalid. On the contrary, the procedure was preferable to allowing a lengthy and complex trial to conclude with one general verdict without any indication as to the legal basis or bases for that verdict. Such an unexplained verdict would risk wasting precious judicial resources since, as Andersen argues, it might be overturned for, *inter alia*, any serious error in the charge relating to a single claim since the reviewing court would be unable to determine the legal basis of the verdict. *See, e.g., Greenbelt Cooperative Publishing Assoc. v. Bresler*, 398 U.S. 6, 11 (1970).

The judgment herein must be sustained if any one of the indicated bases for the verdict is sustained. *See, e.g.,*

Turner v. United States, 396 U.S. 398, 420-21 (1970). Since, as discussed, we affirm on the basis of the claim under section 10(b), one of the bases on which the jury clearly returned its verdict, the verdict procedure poses no bar to our affirming the judgment of the district court.

As to the jury's reference to "state statutes" in its answer to Judge Owen's request, we are unable to say whether this inaccuracy reflects a misstatement in the word "state" or the word "statute." We find unpersuasive MHT's contention that the jury must have meant not the state common law theories but the federal conspiracy and aiding and abetting claims because the jury had the charge on those claims in the jury room and the court had charged that conspiracy and aiding and abetting are "subsidiary theories" to the substantive federal claims. That argument strikes us as little more than an educated guess. The integrity of the jury system and the concern for fairness to litigants simply cannot accommodate such guesswork in sustaining a verdict. In any event, since we affirm on the basis of section 10(b), we need not consider whether Andersen may be liable as an aider and abettor as a matter of law, notwithstanding the verdict procedure, or whether any of the other theories of liability support the jury's verdict.

V.

The parties raise several additional issues, which we can dispose of briefly. First, Andersen argues that the empanelment of the jury was fundamentally unfair because the district judge expressly excused venire persons who could not sit for a trial likely to last several weeks. A jury selection procedure is unconstitutional if it "systematically and intentionally" discriminates or otherwise de-

prives a litigant of a chance to have his case heard by a cross-section of the community. *See Thiel v. Southern Pacific Co.*, 328 U.S. 217, 224 (1946) (automatic exclusion of wage-earners who earn less than four dollars per day held unconstitutional). In the present case, since there was no *per se* exclusion of any group, and no systematic and intentional discrimination against any person or persons, the district judge's empanelment procedure was not unconstitutional.

Andersen also contests the award of pre-judgment interest. The district judge granted MHT's motion to amend the judgment to provide for costs and post-judgment interest, which Andersen did not contest, and for pre-judgment interest. As to pre-judgment interest, in a memorandum and order dated September 12, 1985, the court specifically based its award on the theory that, under N.Y. Civ. Prac. L. § 5001, "[t]he state fraud and negligence findings mandate an award of pre-judgment interest." In our view, the post-verdict inquiry did not result in a legally ascertainable finding of liability under the state common law causes of action, and we instead affirm solely on the basis of section 10(b). Therefore, we cannot say whether the district court order of pre-judgment interest was intended to apply herein. Pre-judgment interest on federal securities claims, unlike on New York state law claims, is not mandatory. *See, e.g., Blau v. Lehman*, 368 U.S. 403, 414 (1962).

We therefore remand to the district court the issue of whether and to what extent pre-judgment interest is appropriate in this case. The purpose of pre-judgment interest is to compensate a plaintiff for loss of the use of funds ultimately awarded. *See, e.g., Freshi v. Grand Cole*

Venture, 767 F.2d 1041, 1051 & n.12 (2d Cir. 1985). Thus, should the district court determine that pre-judgment interest is appropriate, it may further consider the extent, if any, to which MHT had pre-trial use of "deferred credit" funds or of funds received upon release to MHT on May 17, 1982 of certain collateral securities, and the extent, if any, to which MHT's pre-award tax savings on losses due to the DGSI collapse exceed post-award tax liability on the judgment award. Thus, we remand to the district court for resolution of these issues.

Finally, we deny MHT's cross-appeal for a mini-trial on punitive damages. First, the district judge was within his discretion in denying MHT's motion for an amended complaint seeking punitive damages as both untimely and unwarranted. *See* Fed. R. Civ. P. 16; *see also* 3 J. Moore, Moore's Federal Practice ¶ 16.19, at 16-74 (1985). Second, in any event, it is well settled in this Circuit that proof of fraud or misrepresentation in a private civil action, even if such proof would constitute grounds for punitive damages under common law, generally warrants no such damages under the federal securities laws. *See, e.g., Green v. Wolf Corp.*, 406 F.2d 291 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969); *Globus v. Law Research Service, Inc.*, 418 F.2d 1276, 1283 (2d Cir. 1969); *see also* 3A H. Bloomenthal, Securities and Federal Corporate Law § 8.28 [5] (1985) (citing cases).

We have considered the remaining arguments raised herein, and we find them to be without merit.

In light of the foregoing, we affirm the judgment of the district court—excluding its award of pre-judgment interest—on the basis of section 10(b) and Rule 10b-5 thereunder. The cause is remanded to the district court

solely for resolution of Andersen's claims as to pre-judgment interest in a manner not inconsistent with this opinion.

Judgment affirmed in part. Award of pre-judgment interest vacated and remanded.

Transcript of Ruling on Motion to Dismiss
March 23, 1984, pages 42-43

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

82 Civ. 6621, 6622 (RO)

THE CHASE MANHATTAN BANK, N.A.,

Plaintiff,

—v.—

DRYSDALE SECURITIES CORPORATION; DRYSDALE GOVERNMENT SECURITIES, INC.; BMC ACQUISITION CORP., doing business under the name BUTTONWOOD MANAGEMENT; ARTHUR ANDERSEN & CO.; DAVID J. HEUWETTER; JOSEPH V. OSSORIO; and PETER J. WASSERMAN,

Defendants.

MANUFACTURERS HANOVER TRUST COMPANY,

Plaintiff,

—v.—

DRYSDALE SECURITIES CORPORATION; DRYSDALE GOVERNMENT SECURITIES, INC.; BMC ACQUISITION CORP., doing business under the name BUTTONWOOD MANAGEMENT; ARTHUR ANDERSEN & CO.; DAVID J. HEUWETTER; JOSEPH V. OSSORIO; and PETER J. WASSERMAN,

Defendants.

* * *

THE COURT: Counsel, I had a chance, as you observed, to study the papers before I came in today and I've heard your supplimental [sic] and most helpful arguments and I'm constrained to deny this motion.

I would agree that the repos are not pleaded as forcefully as one might have done had the Chemical Bank case been decided before the complaint was drafted, but nevertheless they are in there as an item involved in purchases and sales and it seems to me quite reasonably clear that the repos involved in this case are securities within the meaning of the various authorities including the SEC's letter to which I've had reference.

The ones that the SEC suggests are not separate securities, although Mr. Brooks suggests that they are wrong in making that statement, but the ones that they suggest are not separate securities are ones where there is a loan of the stock, loan of the security for just two or three days or that kind of a thing, and return of it.

Here there are a lot of conditions which hedge it and it is anticipated that it would be kept for quite a period of time with a right to purchase at the end and I think that distinguishes it from the exception in the SEC letter if indeed that need be done.

I also note that Judge Friendly in the Frigitemp/Chemical Bank case observed that one of the things that had motivated him was that the pledge of the stock was merely an incident in the transaction, not otherwise involving the purchase or sale of securities.

Obviously here these repos are the very things that are being bought and it is the rights attendant upon that purchase that are of primary interest.

Given that, obviously then the Arthur Andersen letter is a letter given in connection with a purchase or sale of securities and given that, the result is mandated that the motion to dismiss be denied.

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse, in the City of New York, on the 20th day of October one thousand nine hundred and eighty six.

Nos. 85-7827, 7865, 7929

MANUFACTURERS HANOVER TRUST COMPANY,
Plaintiff-Appellee and Cross-Appellant,

—v.—

DRYSDALE SECURITIES CORPORATION; DRYSDALE GOVERNMENT SECURITIES, INC.; BMC ACQUISITION CORP., doing business under the name BUTTONWOOD MANAGEMENT; ARTHUR ANDERSEN & CO.; DAVID J. HEUWETTER; JOSEPH V. OSSORIO; and PETER J. WASSERMAN,
Defendants,

ARTHUR ANDERSEN & CO.,
Defendant-Appellant and Cross-Appellee.

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by counsel for the defendant-appellant and cross appellee, Arthur Andersen & Co.,

Upon consideration by the panel that heard the appeal, it is

Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges of the court in regular active

service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

/s/ ELAINE B. GOLDSMITH
Elaine B. Goldsmith
Clerk

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket Nos. 85-7827, 7865, 7929

MANUFACTURERS HANOVER TRUST COMPANY,
Plaintiff-Appellee and Cross-Appellant,

—against—

ARTHUR ANDERSEN & CO.,
Defendant-Appellant and Cross-Appellee.

NOTICE OF MOTION
for Stay of Mandate Pending
Application for Writ of Certiorari

MOTION BY: Robert L. King
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875 Third Avenue
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(212) 909-6000

OPPOSING COUNSEL: Barry R. Ostrager
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One Battery Park Plaza
New York, New York 10004
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Has consent of opposing counsel:
A. been sought? Yes
B. been obtained? Yes

Has service been effected? Yes

Is oral argument desired? No
(Substantive motions only)

Has argument date of appeal been set:

A. by scheduling order? N/A
B. by firm date of argument notice? Yes
C. If Yes, enter date: *Appeal argued 3/17/86*

Brief statement of the relief requested:

Order staying the issuance of the mandate pending the filing by Defendant-Appellant Arthur Andersen & Co. of a petition for a writ of certiorari in the United States Supreme Court.

By:	Appearing for: (*Name of Party*)
/s/ Robert L. King	Arthur Andersen & Co.
Robert L. King	October 23, 1986

ORDER

IT IS HEREBY ORDERED that the motion be and it hereby is granted provided that Arthur Andersen & Co. maintains its supersedeas bond. The time for issuance of the mandate herein is extended by 30 days.

/s/ Lawrence W. Pierce

/s/ Roger J. Miner

/s/ Frank X. Altimari
Circuit Judges

10/29/86
Date

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

82 Civ. 6622 (RO)

MANUFACTURERS HANOVER TRUST COMPANY,

Plaintiff,

—against—

ARTHUR ANDERSEN & CO.,

Defendant.

AMENDED JUDGMENT

OWEN, *District Judge*

This case having come on for trial before the Court, the Honorable Richard Owen, and a jury during the period February 4, 1985 through March 21, 1985 and the issues having been duly tried and the jury having rendered its verdict finding Arthur Andersen & Co. liable to Manufacturers Hanover Trust Company in the amount of seventeen million dollars $(17,000,000) and judgment having been entered on March 26, 1985; that judgment is now hereby amended to conform to the Memorandum and Order of this Court dated September 12, 1985, as follows:

It is ordered and adjudged that:

1. Judgment be and hereby is entered in favor of Manufacturers Hanover Trust Company and against Arthur Andersen & Co. in the sum of seventeen million dollars ($17,000,000) together with pre-judgment interest at the rate of 9% beginning on May 17, 1982 together with costs to be taxed by the Clerk.

2. Notwithstanding the existence of claims by Manufacturers Hanover Trust Company against other defendants, the

Court determines that there is no just reason for delay and directs the Clerk of the Court to enter judgment forthwith.

Dated: New York, New York
November 4, 1985

/s/ RICHARD OWEN
United States District Judge

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

82 Civ. 6622 (RO)

MANUFACTURERS HANOVER TRUST COMPANY,

Plaintiff,

—against—

ARTHUR ANDERSEN & CO.,

Defendant.

JUDGMENT

85,0474

A Jury Trial before the Honorable Richard Owen, U.S.D.J., having begun on February 4, 1985, and at the conclusion of the trial the jury having returned a verdict in favor of the plaintiff in the sum of $17,000,000.00,

ORDERED, ADJUGED AND DECREED: That the plaintiff have judgment in the sum of $17,000,000.00 as against the defendant.

DATED: New York, N.Y.
March 22, 1985

/s/

Clerk

THIS DOCUMENT WAS ENTERED ON THE DOCKET ON 3-26-85

SECURITIES ACT OF 1933

Section 3(a)(2), 15 U.S.C. § 77c(a)(2)

Except as hereinafter expressly provided, the provisions of this subchapter shall not apply to any of the following classes of securities:

* * *

(2) Any security issued or guaranteed by the United States or any territory thereof . . .

SECURITIES ACT OF 1933

Section 12(2), 15 U.S.C. § 77*l*(2)

Any person who

* * *

> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

SECURITIES ACT OF 1933

Section 17(a), 15 U.S.C. § 77q(a)

It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

SECURITIES EXCHANGE ACT OF 1934

Section 10(b), 15 U.S.C. § 78j(b)

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

SEC RULE 10b-5

17 C.F.R. § 240.10b-5

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Transcript Excerpts—Verdict Procedure

From charging conference, March 19, 1985:

MR. KING: Finally, they have asked for some sort of special verdict form.

THE COURT: I may give them a special verdict form in which event I will let you see it beforehand.

MR. KING: I would note that in the one they have suggested is Andersen liable, yes, no, and then they said what amount. If they are going to do that, they ought to have no damages or what amount so it is again balanced.

THE COURT: I will show it to you before I use it. (Tr. 5487)

Morning of charge, March 21, 1985:

(In the robing room)

THE COURT: In working up this charge, which frankly boiled down to some reasonable comments, I trust, as your ears will be assailed with it, I did not find satisfactory any form of verdict sheet that I could conceive of of one kind or another. . . . (Tr. 5708)

From Jury Charge:

Now, Manufacturers Hanover seeks recovery under five basic legal theories: three under the federal securities laws, and two under New York state common law, with some subdivisions of the foregoing that I will discuss with you a little bit later. (Tr. 5736)

* * *

Now, as part of these federally based theories, the bank also charges two subsidiary theories: First, that Arthur Andersen

aided and abetted David Heuwetter, Joseph Ossorio, Donald Ruppert, Edward Davis, Drysdale Securities Corp. or Drysdale Government Securities Corp. or some of them in violating the Sections 10(B) and 17(a). (Tr. 5745)

* * *

The bank also seeks to recover on the theory that Andersen through Essner conspired with Ossorio, Heuwetter and others to defraud Manufacturers Hanover and that Andersen is therefore liable for damages caused by the alleged conspiracy. (Tr. 5746)

* * *

Your verdict shall be either in favor of the plaintiff or the defendant, and if your verdict is in favor of the plaintiff you are to state the amount of damage that you find. (Tr. 5759)

Post-Verdict Inquiry

(At 5:48 p.m., the jury entered the courtroom)

THE COURT: You have advised me by note that you have reached a verdict?

THE FOREMAN: Yes, your Honor.

THE CLERK: Ladies and gentlemen of the jury, please answer as I call your name.

(The jury roll was taken and all jurors were present)

THE CLERK: Mr. Foreman, have you reached a verdict?

THE FOREMAN: Yes, we have.

THE CLERK: How do you find?

THE FOREMAN: We find for Manufacturers Hanover.

THE CLERK: In what amount?

THE FOREMAN: $17 million.

THE COURT: Now, I will poll the jury

(The jury was polled, and all jurors answered "Yes, it is," to the question, "Is that your verdict?")

THE COURT: Mr. Foreman, I am going to ask the jury—either you can do it by huddling here or by going back to the jury room—to advise the court on the record of which cause of action or causes of action you base this award on.

Can you do that without retiring? You were given, as you may recall, three statutory causes of action: 10 B, 12(2), and 17(a)(1), and 17(a)(2) and (3). You were given aiding and abetting to consider. You were given a conspiracy charge to consider. You were given a common law fraud, and you were given common law negligence.

I would like you to tell the court, either after having huddled further in the jury room, or if you can put your heads together here, knowing what you have been doing there, and advise the court on the record as to which cause of action or causes of action you have based that award on.

Would you like to retire?

THE FOREMAN: Yes, please.

THE COURT: Very well, you tell me when you are ready.

(At 5:52 p.m., the jury retired to confer)

(Jury not present 6:14 p.m.)

THE COURT: Counsel, I have a note that is a question of what are we expected to state.

It says, "Are we to say what statutes we feel were violated by number, or are we to state why we feel these were violated?"

Just state by number?

MR. KERR: Yes, just by number.

THE COURT: Why don't I ask them to come in and tell them this.

MR. KERR: Assuming they are in agreement.

MR. YELLIN: Your Honor, they may want to consider that.

THE COURT: I will just give them this back, just state by number. State by 10B5, 12(2), 17 A.

(Jury note marked Court's exhibit 4)

(Jury present, 6:17 p.m.)

THE COURT: Mr. Foreman, you are prepared to state which of the statutes you find were violated?

THE FOREMAN: Yes, your Honor. We feel that 10B5, Section 12(2), 17 A and the two state statutes.

THE COURT: Were all violated?

THE FOREMAN: Were all violated.

THE COURT: Do I need to ask the jury further?

Thank you very much. Is there anything further that is needed?

THE CLERK: No, they are excused.

THE COURT: Ladies and gentlemen, thank you very much for your service in this court. It has been long and arduous and deeply appreciated, and you go with, I am sure, the thanks of the Court and the thanks of the lawyers in this room for your service as jurors. You are excused.

Good night.

(The jurors were excused)

(Tr. 5787-90)

Excerpts from Jury Charge on Section 10(b) Claim

And the term "in connection with," as you heard, as an element of certain securities laws, requires proof of some connection between the misrepresentation and the decision to engage in the transaction. (Tr. 5741)

* * *

In order to find Arthur Andersen liable to the bank under Section 10B—that's the first of the three I read you—you must find that Manufacturers Hanover has proven each of the following elements by a fair preponderance of the credible evidence:

That Andersen made

(1) a fraudulent misrepresentation or omission

(2) of a material fact

(3) in connection with the sale or purchase of a security

(4) with scienter, that is, intent to defraud

(5) upon which Manufacturers Hanover reasonably relied

(6) proximately causing its loss. (Tr. 5741-42)

* * *

I further charge you that the repos and reverse repos involved here are securities within the statutes and therefore, you can take this element as established as to each of the federal causes of action. (Tr. 5745)

Manufacturers Hanover's Description of its Contentions (As Read to the Jury by Judge Owen During His Charge)

Manufacturers Hanover claims that the Andersen Report is false and misleading because it falsely represents that Andersen performed an audit of the statement in accordance with Generally Accepted Auditing Standards, and that the statement fairly reflects the financial condition of DGSI in accordance with Generally Accepted Accounting Principles.

Specifically, Manufacturers Hanover claims that no audit was made of the government securities positions which were transferred from Drysdale Securities Corporation to Drysdale Government Securities Inc., and that an audit would have revealed that the government securities positions had a negative worth of approximately minus $190 million.

In this connection, Manufacturers Hanover claims that a portion of the report that states that preferred shares were issued in exchange for assets and liabilities having a net fair value of $5 million was false and misleading because those assets and related liabilities were really worth minus approximately $190 million.

Manufacturers Hanover claims that by issuing the report Arthur Andersen violated the federal securities laws and various state laws.

In addition to alleging that the report violated the securities laws, Manufacturers Hanover alleges that Andersen either conspired with the Drysdale principals to defraud Manufacturers Hanover, or aided and abetted the Drysdale principals in defrauding Manufacturers Hanover. Alternatively, Manufacturers Hanover alleges that Andersen was neglect [sic] in its preparation of the report.

Manufacturers Hanover claims that if Arthur Andersen had not issued Exhibit 1, Manufacturers Hanover would have ceased doing business with DGSI and not sustained $21.3 million in damages due to DGSI's inability to meet its coupon interest obligations on May 17. In other words, Manufacturers Hanover claims that but for Andersen, Manufacturers Hanover would not have lost the money it lost. (Tr. 5726-27)

STATEMENT OF SUBORDINATED DEBT AND EQUITY
AS OF THE OPENING OF BUSINESS
ON FEBRUARY 1, 1982

TOGETHER WITH
AUDITORS' REPORT

ARTHUR ANDERSEN & CO.

ARTHUR ANDERSEN & CO.
New York, N.Y.

To Drysdale Government Securities, Incorporated:

We have examined the accompanying statement of subordinated debt and equity of Drysdale Government Securities, Incorporated as of the opening of business on February 1, 1982. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statement presents fairly the subordinated debt and equity of Drysdale Government Securities, Incorporated as of the opening of business on February 1, 1982, in conformity with generally accepted accounting principles.

/s/ Arthur Andersen & Co.

New York, N.Y.
February 1, 1982.

DRYSDALE GOVERNMENT SECURITIES, INCORPORATED

STATEMENT OF SUBORDINATED DEBT AND EQUITY AS OF THE OPENING OF BUSINESS ON FEBRUARY 1, 1982 (NOTE 1)

SUBORDINATED DEBT (Note 2)	$10,300,000
COMMON SHARES (Note 3)	$ 8,200,000
PREFERRED SHARES (Note 4)	5,000,000
Total equity subscribed	13,200,000
Less—Subscriptions receivable (Note 3)	(2,700,000)
Total equity	$10,500,000
Total subordinated debt and equity	$20,800,000

The accompanying notes are an integral part of this statement.

DRYSDALE GOVERNMENT SECURITIES, INCORPORATED

NOTES TO STATEMENT OF SUBORDINATED DEBT AND EQUITY

AS OF THE OPENING OF BUSINESS ON

FEBRUARY 1, 1982

(1) Organization and business of Company:

Drysdale Government Securities, Incorporated (DGSI) was formed on January 29, 1982, for the purpose of carrying on the government securities trading activity previously conducted by Drysdale Securities Corporation (DSC). DGSI commenced operations on February 1, 1982.

(2) Subordinated debt:

This debt, which is subordinated to the claims of general creditors, was issued on January 29, 1982, to a stockholder for cash equal to the face amount ($10,300,000) and is repayable upon not less than six months' notice by the holder; in no event is the Company obligated to repay the indebtedness prior to one year from issuance.

(3) Common shares:

Common shares were issued on January 29, 1982, for $5,500,000 of cash. Additional shares have been subscribed to for $2,700,000. The anticipated date of payment of the subscriptions receivable will be no later than June 30, 1982.

(4) Preferred shares:

The preferred shares were issued to DSC in exchange for operating assets and related liabilities having a net fair value of $5,000,000.

No. 86-875

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARTHUR ANDERSEN & CO.,

Petitioner,

—v—

MANUFACTURERS HANOVER TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

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JOHN J. KERR, JR.
DAVID E. MASSENGILL
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Of Counsel

December 24, 1986

QUESTIONS PRESENTED

1. Should this Court exercise its supervisory powers to review unanimous determinations by the Court of Appeals for the Second Circuit that the jury procedure followed by the trial court was correct, and that in any event Petitioner waived any right to object by ignoring repeated requests from the trial court for objections?

2. Should this Court grant certiorari to review the Court of Appeals' application of settled principles of securities law to facts determined by a jury after a seven week trial?

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TABLE OF AUTHORITIES

IN THE

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ARTHUR ANDERSEN & CO.,

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Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY IN OPPOSITION

Respondent Manufacturers Hanover Trust Company ("MHTCo")[1] respectfully submits that the Petition of Arthur Andersen & Co. ("Andersen") for a writ of certiorari should be denied.

COUNTERSTATEMENT OF THE CASE

Background

In February 1982 Andersen misrepresented to MHTCo in a financial statement and Opinion Letter (A57-A59)[2] that Drysdale Government Securities Incorporated ("DGSI") had an opening capitalization of $20.8 million. A4-A5, A14. The

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1 Respondent's Statement pursuant to Supreme Court Rule 28.1 is set forth as the Appendix to this brief.

2 "A" refers to the Appendix to the Petition.

Opinion Letter stated that the DGSI financial statement had been examined by Andersen "in accordance with generally accepted auditing standards" and that the statement "fairly reflected" DGSI's capitalization. The Opinion Letter was sent to MHTCo to induce MHTCo to engage in repurchase and reverse repurchase agreements ("repos") on DGSI's behalf.[3] After DGSI collapsed in May 1982, it was discovered that DGSI started business with a *negative* net worth of $190 million. A4-A5.

The fraudulent DGSI financial statement and accompanying Andersen Opinion Letter were essential parts of a "Ponzi" scheme run by DGSI that resulted in more than $300 million in losses by banks that, in reliance on Andersen's fraudulent Opinion Letter, entered into repurchase and reverse repurchase agreements on DGSI's behalf. A4-A6, A8 n.4, A9 n.5.

After a seven week trial, a jury found that Andersen violated the federal securities laws by intentionally or recklessly misstating DGSI's opening capitalization. A51.

The Evidence at Trial

The evidence at trial established that Warren Essner, the senior Andersen auditing partner who prepared both the fraudulent DGSI financial statement and the Opinion Letter: (i) prepared his "audit" of DGSI without consulting any of DGSI's books or records; (ii) manufactured work papers; and (iii) violated seven separate requirements of Generally Accepted Auditing Standards and at least seven separate internal Andersen requirements for conducting an audit. A7-A9, nn. 4, 5. MHTCo also proved that Essner knew that MHTCo required an auditor's report before it would enter into repur-

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3 A repurchase agreement is the sale of a security with an agreement to repurchase the security at a later date at a fixed price. A reverse repurchase agreement is the purchase of a security with an agreement to resell the security at a later date at a fixed price. A4-A5. *See In re Bevill, Bresler & Schulman Asset Management Corp.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,966, at 94,712 (D.N.J. Oct. 23, 1986).

chase contracts on DGSI's behalf, and knew that MHTCo was relying upon the Andersen Opinion Letter to decide whether to enter into such contracts. A8, A14-A15, A17-A18.[4]

The Verdict Procedure

The jury was instructed with respect to MHTCo's federal and state law claims. After the jury returned a verdict against Andersen for $17 million, the trial court proposed to counsel that the jury state the causes of action upon which the verdict was based. A51-A53. Andersen, represented by experienced trial lawyers, made no objection. The jury left the courtroom to consider the judge's request. A52. After the jury returned and stated that it had found for MHTCo on the federal and state law claims, the court turned to counsel and asked: "Do I need to ask the jury further?" Andersen was silent. The court then asked: "Is there anything further that is needed?" Andersen remained silent. A53.

REASONS FOR DENYING THE WRIT

The Petition raises no important issues of law or policy. Andersen seeks only a review of a jury verdict that came after an error-free seven week trial which involved no significant legal issues.

I. THE COURT OF APPEALS PROPERLY HELD THAT THE VERDICT PROCEDURE WAS CORRECT AND THAT IN ANY EVENT ANDERSEN WAIVED ANY OBJECTION BY ITS REPEATED FAILURES TO OBJECT

Andersen asks this Court to use its supervisory powers to review the verdict procedure. Andersen complains, contradictorily, that either (i) the jury was allowed to provide too much

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4 On December 15, 1986, Warren Essner entered into a consent decree with the SEC arising out of his conduct in preparing the DGSI statement and Andersen Opinion Letter.

information about its verdict, *i.e.*, that Andersen violated federal and state antifraud laws, or (ii) the jury did not provide enough information about its verdict.

The Court of Appeals properly approved the verdict procedure. A28-A32. Contrary to Andersen's assertions, the trial court did not ask the jury to reconsider its findings. The jury was simply asked to enumerate the specific counts upon which it based its verdict. A26-A27.

Even if the verdict procedure had been objectionable, Andersen waived any right to object. Andersen did not take issue with any aspect of the verdict procedure, despite repeated opportunities and despite requests from the trial court for comments or objections. A10, A51-A53. This Court has consistently held that when a party, for tactical or other reasons, waives an objection, that waiver will be enforced, even in cases dealing with life or death. *See Smith v. Murray*, 106 S. Ct. 2661 (1986); *Engle v. Isaac*, 456 U.S. 107 (1982); *Wainwright v. Sykes*, 433 U.S. 72 (1977).

II. THE COURT OF APPEALS CORRECTLY APPLIED SETTLED PRINCIPLES OF SECURITIES LAW IN HOLDING THAT ANDERSEN'S FRAUD WAS "IN CONNECTION WITH" CONTRACTS TO PURCHASE OR SELL SECURITIES

The Court of Appeals affirmed the jury's verdict that Andersen's fraud was "in connection with" contracts to purchase or sell securities, and thus a violation of § 10(b) of the 1934 Securities Exchange Act, 15 U.S.C. § 78j(b), and Securities and Exchange Commission Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5. In affirming the verdict, the Court of Appeals properly applied settled principles of securities law to the particular facts of this case.

In this case and in the parallel SEC enforcement action against Warren Essner for his role in the Drysdale fraud, *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*

sub nom. Essner v. SEC, 106 S. Ct. 2894 (1986), the Court of Appeals held that where the very intent and purpose of a fraud is to induce the purchase or sale of a security, the fraud is "in connection with" that purchase or sale.[5] *See SEC v. Drysdale, supra* at 40-42; A11-A14, A18. As both opinions make clear, this principle is consistent with *Chemical Bank v. Arthur Andersen & Co.*, 726 F.2d 930 (2d Cir.), *cert. denied*, 469 U.S. 884 (1984), and with a long line of Second Circuit decisions addressing § 10(b)'s requirement that fraud be "in connection with" the purchase or sale of a security. *SEC v. Drysdale, supra*, at 40-43; A10-A13, A14, A18.

The Court of Appeals' decision is also consistent with the current Congressional understanding of the antifraud provisions of the securities laws. The House Report of the Government Securities Act of 1985 (enacted as the Government Securities Act of 1986) notes that:

> Fraud in connection with repurchase or reverse repurchase transactions, including misrepresentations concerning the financial condition of the brokerage firm effecting the transactions, is covered by the antifraud provisions of the federal securities laws. The Committee believes that the district court's decision to the contrary in *SEC v. Drysdale Securities Corp., appeal pending* No. 85-6111

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5 Both decisions applied the reasoning of *Superintendent of Insurance v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971) in analyzing the "in connection with" requirement of § 10(b). Andersen contends that this issue was reopened in *Rubin v. United States*, 449 U.S. 424 (1981). In fact, *Rubin* dealt only with whether a pledge of a security as collateral for a loan is a sale for purposes of § 17(a) of the 1933 Act (15 U.S.C. § 77q). The comment in footnote 6 of *Rubin* merely states that this Court was not automatically extending the scope of the securities laws to cover every conventional bank loan that might be secured in part by a pledge of securities. *Rubin* did not purport to limit *Superintendent of Insurance*, and *Rubin* has not been construed as doing so. *See Angelastro v. Prudential-Bache Securities, Inc.*, 764 F.2d 939, 946 (3d Cir.), *cert. denied*, 106 S. Ct. 267 (1985); *Chemical Bank v. Arthur Andersen & Co., supra*, 726 F.2d at 944.

> (2d Cir.) [*reversed*, 785 F.2d 38 (2d Cir.), *cert. denied sub nom. Essner v. SEC*, 106 S.Ct. 2894 (1986)], is incorrect.

H.R. Rep. No. 258, 99th Cong., 1st Sess. 17 n.22 (1985).

The Court of Appeals properly applied this well-established principle both in this case and in reversing the district court decision in *SEC v. Drysdale*. The purpose and intent of Andersen's fraud was to cause the banks to enter into contracts to buy securities at a set price, and into contracts to deliver securities at a set price. When DGSI collapsed, those contracts were binding on the banks. A20.

Thus, unlike the situation in *Chemical Bank v. Arthur Andersen & Co., supra*, 726 F.2d at 944 n.24, this is not a case where the fraud relates only incidentally or fortuitously to a securities transaction. The sole purpose of Andersen's fraud was to induce banks such as MHTCo to enter into contracts to purchase and sell securities. Andersen's fraud thus directly and intentionally "touched" the securities transactions in this case, easily meeting the test set forth by this Court in *Superintendent of Insurance, supra*, 404 U.S. at 12-13.

Andersen claims, however, that the Court of Appeals erred in holding that Andersen's fraud was a violation of the securities laws, because the trial court charged the jury that repos were securities. Andersen argues that this charge was error, and that a jury finding that Andersen's fraud was "in connection with" repos does not support a verdict that Andersen violated § 10(b).

The Court of Appeals, however, recognized that it did not have to determine if the repos in this case were securities, since Andersen's fraud in connection with repurchase agreements was itself a violation of § 10(b). A13-A14. This was not a new or radical expansion of the law by the Court of Appeals. It was the logical application of the definition of "purchase or sale" in the Exchange Act.

The Exchange Act states that "purchase or sale" includes "contract[s] to buy, purchase or otherwise acquire securities."

15 U.S.C. § 78c(a)(13). Since repurchase and reverse repurchase agreements are contracts to purchase or sell securities (A12), § 10(b)'s prohibition against fraud in connection with the purchase of securities also bars fraud in connection with repurchase agreements.[6] This conclusion is not new. *See* Securities Act Release No. 33-6351, 1 Fed. Sec. L. Rep. (CCH) ¶ 2024, at 2559-2 (Sept. 25, 1981). The SEC urged it in its *amicus* brief below. A13 n.6. The application of § 10(b) to the facts of this case hardly warrants this Court's plenary review.

CONCLUSION

The Petition for a writ of certiorari should be denied.

Respectfully submitted,

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Respondent Manufacturers
Hanover Trust Company

John J. Kerr, Jr.
David E. Massengill
David W. Sussman
Of Counsel

December 24, 1986

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6 The logical steps followed by the Court of Appeals are simple and obvious:

— a "purchase of a security" includes a contract to purchase a security;

— a repurchase agreement is a contract to purchase a security;

— therefore, § 10(b) bars fraud in connection with a repurchase agreement.

APPENDIX

RULE 28.1 LISTING

The parent company of Respondent Manufacturers Hanover Trust Company is Manufacturers Hanover Corporation.

The subsidiaries (except wholly owned subsidiaries) and affiliates of Manufacturers Hanover Trust Company are: Manufacturers Hanover Leasing S.p.A.; Arrendadora Bancomer, S.A. de C.V.; P.T. Manufacturers Hanover Leasing Indonesia; Manufacturers Hanover de Arrendamiento Financiero S.A.; Korea Industrial Leasing Co., Ltd.; Manufacturers Hanover Leasing S.p.A.; and CSW Leasing, Inc.

No. 86-875

(3)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1986

ARTHUR ANDERSEN & CO.,

Petitioner,

—v.—

MANUFACTURERS HANOVER TRUST COMPANY,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

REPLY BRIEF OF PETITIONER ARTHUR ANDERSEN & CO.

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Petitioner Arthur Andersen & Co. ("Andersen")[1] submits this brief in response to points raised in the Brief in Opposition filed by Respondent Manufacturers Hanover Trust Company ("MHT") on December 24, 1986 ("MHT Br.").

1 Andersen is a general partnership, not a corporation; Rule 28.1 does not apply.

I.

Andersen Did Not Waive Its Challenges to the Legal Significance of the Post-Verdict Inquiry.

Andersen's silence when the trial court made its post-verdict inquiry was not a waiver of Andersen's right to challenge the court of appeals' use of that inquiry to create a separate "10B5" verdict.

The trial was concluded when the jury returned the general verdict that the trial court had instructed it to return. A50-A52.[2] Further inquiry of the jury was without legal significance. Pet. 6-11.

Since Andersen's challenge is to the legal significance of the post-verdict inquiry—not to the language of the inquiry itself or to any other matter that could have been cured had objection been made at the time of the inquiry—the proper time to raise Andersen's challenge was when MHT first suggested to the trial court that the judgment should reflect separate verdicts on MHT's respective claims. Andersen promptly did so, leading the trial court to enter a judgment reflecting the jury's general verdict. A42-A43. MHT's claim of waiver is therefore spurious.

The cases MHT cites in support of its waiver claim are not even remotely on point. They all involve a collateral attack on a judgment affirmed on direct appeal. *See Smith v. Murray*, 106 S. Ct. 2661 (1986) (waiver by deliberate decision not to raise issue on direct appeal); *Engle v. Isaac*, 456 U.S. 107 (1982) (waiver by not objecting to erroneous jury instruction despite Ohio criminal rule requiring objection before jury retires); *Wainwright v. Sykes*, 433 U.S. 72 (1977) (waiver by not making a motion to suppress before trial despite Florida criminal rule requiring timely motion).

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2 "A" refers to the Appendix to the Petition. "Pet." refers to the Petition.

II.

The Court of Appeals' Refusal to Review Each of MHT's Three Theories of "10B5" Liability Was Contrary to This Court's Decisions.

The court of appeals' assumption that the jury found a "primary" violation of Section 10(b), and its refusal to review the other two theories of Section 10(b) liability that were submitted to the jury (aiding and abetting and conspiracy), was directly contrary to the appellate procedure mandated by the decisions of this Court. *See* Pet. 11-13. MHT does not even attempt to defend the court of appeals' use of *Turner v. United States*, 396 U.S. 398, 420-21 (1970), to negate the clear holding of *Greenbelt Cooperative Publishing Ass'n v. Bresler*, 398 U.S. 6, 11 (1970), decided later in the same term.

MHT instead misleadingly suggests that its "waiver" arguments apply to the court of appeals' refusal to review the alternative bases of Section 10(b) liability. MHT Br. 3-4. But the court of appeals never held, and could not have held, that Andersen waived its challenge on this issue. The court of appeals just refused, without explanation, to review each of MHT's three theories of Section 10(b) liability, A32, A38, though Andersen clearly delineated the court's duty to do so in Andersen's initial briefs and in its Petition for Rehearing.

Andersen had no duty to ask for further clarification of the jury foreman's statement that "10B5" had been violated,[3] as MHT suggests. MHT Br. 3. Andersen preserved its objections to the legal sufficiency of MHT's aiding and abetting and

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3 The jury foreman gave no indication of which of MHT's three theories of "10B5" liability formed the basis of his statement. A53. To the extent the court of appeals interpreted the jury foreman's statement as a finding of a "primary" violation, the court was subject to the very same criticism that it leveled at other suggested interpretations of the foreman's response: "[t]he integrity of the jury system and the concern for fairness to litigants simply cannot accommodate such guesswork in sustaining a verdict." A32.

conspiracy claims by objecting to the court's instructions. It had no responsibility to request separate verdicts on each of these theories of Section 10(b) liability. This Court has consistently overturned general verdicts where one of the underlying claims is legally deficient, Pet. 12, without requiring the party challenging the general verdict to ask for separate verdicts in order to preserve its objections.

Moreover, MHT had the same opportunity to clarify the jury foreman's "10B5" response as did Andersen. MHT seeks to use the post-verdict questioning to elicit a separately-sustainable jury finding of a "primary" violation of Section 10(b). MHT, not Andersen, should bear the risk of failure to obtain clarification of the jury's response.

III.

Andersen Was Entitled to a Jury Determination, After Proper Instructions, Whether Its Alleged Fraud Was "In Connection With" the Purchase or Sale of Securities.

The entire thrust of MHT's argument in Point II of its brief, MHT Br. 4-7, is that a properly-instructed jury could have concluded that Andersen's alleged fraud was "in connection with" the purchase and sale of securities. This misses the point. The jury was not given proper instructions on this issue, and Andersen's alleged fraud was not *necessarily* "in connection with" MHT's purchase or sale of government bonds, as the court of appeals wrongly held. The effect of the court of appeals' decision was to deprive Andersen of its right to a jury determination of this issue, which was crucial to federal court jurisdiction over this case.

The jury was told that repos are themselves "securities" and that "you can take this element as established as to each of the federal causes of action." A54. It was not given any guidance as to the meaning of the "in connection with" requirement and was never asked to consider whether the alleged fraud was "in connection with" bonds that MHT purchased and sold.

If the issue had been submitted to it, the jury reasonably could have concluded that Andersen's alleged fraud was not "in connection with" MHT's purchase and sale of bonds. MHT alleged that "but for" Andersen's report MHT's credit department would not have allowed MHT's Securities Lending Department to continue doing business with Drysdale. A55. Under similar circumstances district courts have even dismissed claims for lack of sufficient causation. *See, e.g., Bochicchio v. Smith Barney, Harris Upham & Co.*, 85 Civ. 6544 (PKL) (S.D.N.Y. Nov. 18, 1986; available on Lexis) (misrepresentations of brokerage firm account representative that induced plaintiff to open an investment account did not pertain to any securities traded in that account); *First Federal Savings & Loan Ass'n v. Oppenheim, Appel, Dixon & Co.*, 629 F. Supp. 427, 441-42 (S.D.N.Y. 1986) (alleged fraudulent misrepresentations by accountants concerning the financial condition of a government securities dealer did not proximately cause plaintiffs' losses although they allegedly caused plaintiffs to purchase the securities that led to their losses).

The court of appeals attempted to brush aside the absence of a jury finding on this important issue by holding that a repo is a "contract" to buy or sell securities and that any fraud "in connection with" such a contract is necessarily fraud "in connection with" the purchase or sale of the underlying securities. But it is plainly too broad to hold that any fraud affecting a contract is *necessarily* fraud in connection with a securities transaction that may be part of the contract.[4] This holding is

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4 *SEC v. Drysdale Securities Corp.*, 785 F.2d 38 (2d Cir.), *cert. denied*, 106 S.Ct. 2894 (1986) does not support this far-reaching determination. Pet. 15-16. Neither does H.R. Rep. No. 258, 99th Cong., 1st Sess. 17 n. 22 (1985), quoted at MHT Br. 5-6, which merely predicted the court of appeals' reversal of the district court decision in *SEC v. Drysdale*. Nor did the SEC itself urge this determination, as suggested by MHT. MHT Br. 7. The very authorities there cited, Securities Act Release No. 33-6351 and the SEC's amicus brief below, emphasize that the application of the antifraud provisions of the federal securities laws "depends on the facts and circumstances surrounding each individual transaction." 1 Fed. Sec. L. Rep. (CCH) ¶ 2024, at 2559-3 (Sept. 25, 1981); *see* SEC Amicus Brief at 7 n. 12 (April 1986).

not in accord with "settled principles," MHT Br. 4, and such rulings do violence to settled principles by extending the reach of the federal securities laws to claims that properly belong in state courts.[5]

The "in connection with" requirement focuses on securities transactions themselves, and not on general relationships of which securities transactions may be a part. The court of appeals simply went too far in holding that any fraud affecting MHT's repo business with Drysdale (such as the alleged "door opening" effect of MHT's credit department's reliance on Andersen's report) was *necessarily* fraud "in connection with" the hundreds of individual bond transactions into which MHT entered. The proper meaning of the "in connection with" requirement requires clarification by this Court, Pet. 13-16, and the Court should issue a writ of certiorari to provide that clarification in this case.

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5 *Technology Exchange Corp. of America v. Grant County State Bank*, 646 F. Supp. 179 (D. Colo. 1986), is a recent example of such a ruling. There, the court held that a fraud that induced plaintiff to enter into a contract to manage property was actionable under § 10(b) and Rule 10b-5 because a stock bonus was contingent compensation under the contract. The court reasoned that "Section 10 is designed to remedy all situations where fraudulent practices have been used in the connection with the purchase or sale of securities regardless of the actual terms of the purchase or sale." 646 F.Supp. at 182.

CONCLUSION

For the foregoing reasons and those stated in the Petition, a writ of certiorari should issue to review the judgment and opinion of the Court of Appeals for the Second Circuit.

Respectfully submitted,

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